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Papers and Proceedings

of the

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of the

American Economic Association

Being the Fiftieth Anniversary
of the Founding of the Association

Edited by the Secretary of the Association

Inquiries and other communications regarding membership, meetings, and the general affairs of the Association, as well as orders for publications, should be addressed to the Secretary of the American Economic Association, Northwestern University, Evanston, Illinois.

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TABLE OF CONTENTS

PROGRAM OF THE FORTY-EIGHTH ANNUAL MEETING

THURSDAY, *December 26, 1935*

2:30 P.M.

1. *Recovery, 1933-35: Distinguishing Characteristics*
   Chairman: John T. Madden, New York University
   Papers: Garfield V. Cox, University of Chicago; Isador Lubin,[1] Commissioner of Labor Statistics
   Discussion: Willford I. King, New York University; Lionel D. Edie,[1] Edie-Davidson, Inc.; T. J. Kreps, NRA
2. *The Problem of Rigid and Flexible Prices*
   Chairman: Rexford G. Tugwell, Undersecretary of Agriculture
   Papers: Willard L. Thorp, Dun and Bradstreet's; Gardiner C. Means, Department of Agriculture; Ralph C. Epstein and John D. Sumner, University of Buffalo; Spurgeon Bell, Federal Home Loan Bank Board
   Discussion: F. C. Mills, Columbia University; Frank G. Dickinson, University of Illinois; H. L. McCracken, Louisiana State University

5:00 P.M. *Meeting of the Executive Committee*

8:00 P.M.

1. *A Fifty-year Perspective in Economic History* (joint meeting with the Business Historical Association)[2]
   Chairman: Percy S. Straus, R. H. Macy and Company
   Papers: Herbert von Beckerath, University of North Carolina; N. S. B. Gras, Harvard University
   Discussion: Anne Bezanson, University of Pennsylvania; Carter Goodrich, Columbia University; E. J. Hamilton, Duke University; John U. Nef, University of Chicago
2. *Free Competition vs. Controlled Competition*
   Chairman: Leon Henderson, Economic Adviser, Senate Committee on Manufactures
   Papers: Henry Simons, University of Chicago; Donald H. Wallace, Harvard University; Gustav Seidler,[1] NRA
   Discussion: Abraham Berglund, University of Virginia; Arthur R. Burns, Columbia University; Albert Abrahamson,[1] United States Works Progress Administrator for Maine

FRIDAY, *December 27, 1935*

9:00 A.M. *Business Meeting (Reports of Officers and Committees, etc.)*

10:00 A.M.

1. *Banking Problems*
   Chairman: George W. Edwards, College of the City of New York
   Papers: John H. Williams, Harvard University; Jacob Viner, University of Chicago
   Discussion: E. A. Goldenweiser, Federal Reserve Board; C. O. Hardy,[1] Brookings Institution; Frederick A. Bradford,[1] Lehigh University
2. *Economic Aspects of an Integrated Social Security Program* (Round Table)
   Chairman: Sumner Slichter, Harvard University
   Papers: Ewan Clague, Pennsylvania School of Social Work; Eveline M. Burns,[3] Columbia University
   Discussion: William Haber, State Relief Administrator, Michigan; J. Douglas Brown, Princeton University; Sumner Slichter, Harvard University

2:30 P.M.

1. *Capital Formation* (Round Table)
   Chairman: Alvin S. Johnson, New School for Social Research
   Discussion: Harold G. Moulton, Brookings Institution; David Friday, Domestic and Foreign Investors Corporation; Simon Kuznets, National Bureau of Economic Research; Gustav Kleene, Trinity College; A. B. Wolfe, Ohio State University; R. T. Bye, University of Pennsylvania; David Cushman Coyle, New York City

[1] No manuscript received.
[2] To be published by the Business Historical Association.
[3] To be published in full in the *American Economic Review*.

2. *International Trade in Farm Products* (Round Table)[4]
Chairman: John D. Black, Harvard University
Papers: Frank D. Graham, Princeton University; L. R. Edminster, AAA
Discussion: Henry C. Taylor, The Farm Foundation; Mordecai Ezekiel, United States Department of Agriculture; Henry I. Richards, Brookings Institution

8.00 P.M.
Chairman: F. W. Taussig, Harvard University
Papers: Richard T. Ely, Institute for Economic Research; Emil Lederer, New School for Social Research; J. M. Clark,[5] Columbia University

SATURDAY, *December 28, 1935*

9:00 A.M. *Business Meeting (Election of Officers, etc.)*

10:00 A.M.

1. *Problems in Public Finance*
Chairman: R. M. Haig, Columbia University
Papers: Harley L. Lutz, Princeton University; Clarence Heer, University of North Carolina; Mabel Newcomer, Vassar College
Discussion: Carl Shoup, Columbia University; James W. Martin, University of Kentucky; R. S. Van de Woestyne, Knox College

2. *Planning for Stabilization vs. Adjusting to Instability*
Chairman: Lewis L. Lorwin, International Labor Office
Papers: A. F. Hinrichs,[1] Bureau of Labor Statistics; S. H. Slichter, Harvard University
Discussion: George Soule, *The New Republic;* Harry W. Laidler, League for Industrial Democracy; Eduard Heimann, New School for Social Research

3. *Transportation Problems* (Round Table)
Chairman: I. Leo Sharfman, University of Michigan
Discussion: J. R. Turney, Office of the Federal Co-ordinator of Transportation; L. C. Sorrell, University of Chicago; W. M. W. Splawn, Interstate Commerce Commission; W. J. Cunningham, Harvard University; C. O. Ruggles, Harvard University; D. P. Locklin, University of Illinois; Carson S. Duncan, Washington, D.C.; Truman C. Bigham, University of Florida; Charles L. Raper, Syracuse University

12:00 M. *Meeting of the Executive Committee*

2:30 P.M.

1. *Fifty Years' Developments in Allied Fields*
Chairman: Morris R. Cohen, College of the City of New York
Papers: C. E. Ayres, University of Texas; John R. Commons, University of Wisconsin; Karl N. Llewellyn,[1] Columbia University
Discussion: Willard E. Atkins, New York University; E. S. Robinson, Yale University

2. *Equivalents for Value Theory in a Collectivist Economy*
Chairman: Harry W. Laidler, League for Industrial Democracy
Papers: F. H. Knight, University of Chicago; Alexander Gourvitch, Washington, D.C.
Discussion: Calvin B. Hoover, AAA; William Orton, Smith College; Michael Florinsky, Columbia University

3. *Effects of New Deal Legislation on Industrial Relations* (Round Table)
Chairman: David A. McCabe, Princeton University
Discussion: Harry A. Millis, University of Chicago; Edward S. Cowdrick, New York City; David J. Saposs, New York City; Carroll R. Daugherty, University of Pittsburgh; William M. Leiserson, National Board of Mediation

6:30 P.M. *Dinner Meeting*
Toastmaster: Frank A. Fetter, Princeton University
Speakers: J. B. Clark, Columbia University; E. R. A. Seligman, Columbia University; F. W. Taussig, Harvard University; Davis R. Dewey, Massachusetts Institute of Technology; R. T. Ely, Institute for Economic Research; Francis Walker, Federal Trade Commission; W. A. Mackintosh, Queen's University; J. M. Clark, Columbia University; Alvin S. Johnson, New School for Social Research

[4] This meeting was not reported in the regular way, but the paper of Mr. Edminster is printed in full instead.

[5] The presidential address will be published in the March number of the *American Economic Review*.

THE purpose of the American Economic Association, according to its charter, is the encouragement of economic research, the issue of publications on economic subjects, and the encouragement of perfect freedom of economic discussion. The Association as such will take no partisan attitude, nor will it commit its members to any position on practical economic questions. It is the organ of no party, sect, or institution. Persons of all shades of economic opinion are found among its members, and widely different issues are given a hearing in its annual meetings and through its publications. The Association, therefore, assumes no responsibility for the opinions expressed by those who participate in its meetings.

F. S. Deibler

Secretary

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SOME DISTINGUISHING CHARACTERISTICS OF THE CURRENT RECOVERY

By GARFIELD V. COX
University of Chicago

This is the thirty-third month since business in the United States began its rise from the extreme lows of the depression. Thus far the pattern of the improvement has been unusual and in some ways probably unique, while certain of the influences playing upon it have been equally novel. A brief discussion of these unusual features must be inadequate and will doubtless prove to have been in many respects erroneous. Yet most of us are continually attempting such analysis even though we may refrain from sharing our interpretations with others. Curiosity and the necessity of action, individual or collective, do not permit us to postpone interpretation of current economic events until a highly scientific judgment may be rendered upon their significance.

The National Bureau of Economic Research has identified twenty successive business cycles as having run their course in the United States from January, 1855, to March, 1933. It has constructed a series of "standard reference dates" consisting of four dates for each cycle.[1] These four dates are, respectively, the months in which expansion begins and ends and the months in which contraction starts and terminates. According to the National Bureau's schedule business is now in an expansion phase which began with April, 1933.

Some students of business fluctuations regard midsummer, 1932, as marking the beginning of revival in the United States. The volume of industrial production reached a lower level in 1932 than in 1933 and so did industrial stock prices. The number of wage earners also appears to have been as low in 1932 as in early 1933. Abroad, improvement in economic conditions in a plurality of countries began in 1932. But the National Bureau has chosen March, 1933, as marking the final month of contraction in the United States, on the ground that more significant economic time series made their lows that month than in the previous summer.

On the basis of the National Bureau's reference dates, only two peace-time periods of expansion in the last eighty-one years have lasted longer than the current one has already run. The two in question were the 34 months from January, 1871, to October, 1873, and the 36 months from April, 1879, to March, 1882. A third expansion of 33 months from September, 1904, to May, 1907, just equals in duration the current recovery to date. The arithmetic average length of the twenty completed expansion periods is 25 months; and, if the Civil and World War periods are omitted, the average duration of the 18 remaining upswings is 23 months.

[1] For reference dates through June, 1929, see J. M. Clark's *Strategic Factors in Business Cycles*, p. 11.

Not only is the current recovery taking an exceptional amount of time, but its pattern in other respects exhibits characteristics unusual if not unique in American experience. Probably the only currently published monthly index of business activity which has been carried back as far as the foregoing set of reference dates is Colonel Ayres' index of "American Business Activity Since 1790."[2]

For the years beginning with 1919 the Ayres index is the industrial production composite of the Federal Reserve Board, reduced by him to a per capita basis and adjusted for long-time trend, as also were the data from the various sources for the earlier years. The Ayres index registers all of the expansion periods designated by the National Bureau. As to the months when expansion began the index and the reference dates are in close agreement four times out of five; in the remaining instances the index tends to lead the reference dates. As to the months when expansion culminated the agreement is equally close save for the Civil and World War periods when the index leads, and for two recoveries near the turn of the century when the index lags.

Recognizing that this index is necessarily less reliable the farther back it is carried, there is ample ground for considering it a sufficiently accurate measure of the ebb and flow of industrial activity over the last eighty years to warrant a few rough quantitative comparisons. First, expansion this time began from a level roughly twice as far below estimated normal as in any previous instance. Second, all previous recoveries, once started, have brought the index of business activity back to normal rather rapidly. The longest period elapsing between the National Bureau's date for the beginning of expansion and the time at which Ayres' index reached its trend line was 14 months; this time after 33 months this index is still substantially below trend. Even allowing for the greater ground which industrial activity has this time had to recover, the current record compares unfavorably. This brings us to a third observation; namely, that no previous recovery from depression has been punctuated by reversals so extensive as those which have interrupted the current expansion. With trend taken as 100 the largest reaction previously registered was one of 5 points during the upswing of 1895. In contrast to this is our current experience in which the index declined more than 25 points from July to November, 1933, approximately 14 points from May to September, 1934, and over 5 points from January to May of 1935. In short, the course of the current recovery has been erratic beyond all precedent, with swift and extensive advances largely canceled by sharp and serious declines.

The additional fact of the spottiness of the current improvement has not of itself been so unusual. The indexes of business in various fields have

[2] See chart issued in 1931 and current numbers of *The Cleveland Trust Company Business Bulletin*, both published by the Cleveland Trust Company.

typically shown much less conformity in the early stages of upswings than of downswings. The processes of expansion appear usually to have been somewhat more erratic than the processes of contraction. But the disparities this time have been exceptionally great and some of them unique in character. Most striking is the small part played thus far by private construction and by the production of durable producers' goods. The statistics and annals of business for the United States are sufficient as far back as 1870 to make it clear that from that date, at least, the production of durable goods played an early and outstanding part in every peace-time recovery down to 1933. In the 1870's and 1880's railroad construction was invariably a conspicuous contributor to expansion from its earliest stages onward. In subsequent decades railroad construction gave way in importance to broadly diversified types of building, and to equipment provision for industry, transportation, and public utilities, with automobiles rising to high rank during the last fifteen years. But, whatever the principal directions the production of durable goods might take in any given recovery, the great increase in iron and steel output has invariably served notice of the fact that such production was taking place in large volume. In no important recovery in eighty years have iron and steel and durable goods in general lagged as they have from 1933 to 1935. But for a substantial revival in automobile and machinery output and a considerable increase in the construction of public works the advance in the durable goods sector would thus far have been small, indeed.

The behavior of the general wholesale price level has also been a striking feature of this recovery. Almost half of the rise which has developed in thirty-three months took place by the end of July, 1933, in less than four months after our abandonment of the gold standard. In the early stages of most of our business revivals hitherto the physical volume of business activity has led commodity prices and in no recovery since 1855 have commodity prices at wholesale registered so sharp an advance so early in recovery as in this instance.

The lagging physical volume of our international trade is another distinguishing characteristic of the current business expansion. In past recoveries, imports have practically always expanded promptly and substantially; and, if other countries were also recovering from depression as they have been in this period, the increase in our exports was usually sufficient to contribute materially to domestic improvement. In the current expansion, however, both imports and exports have lagged. In dollar terms there was a slight gain in exports in the second half of 1933, a small further increase in 1934, and no material change during the current year until the increase just reported for November. In imports the gain of 1934 over 1933 was even smaller than that in exports. In 1935, however, the dollar value of imports has run 20 per cent ahead of last year while exports showed little change until November. In terms of physical volume the increase in our

exports over those of 1932 has been nominal and the gain in imports has been quite small. In terms of gold prices both imports and exports are substantially below the levels of 1932.

Our current volume of foreign trade appears less extraordinary, however, when viewed in the light of developments in international trade in the world as a whole. During the period of business contraction the physical quantity of international trade, both for the world and for the United States, appears to have declined less than did the volume of industrial production. This discrepancy was largely due to the fact that foodstuffs, trade in which was relatively well maintained down to 1932, were a larger item in international trade than was food processing in the industrial activity of the various nations. The *Economic Intelligence Service* of the League of Nations[3] has estimated changes in the physical volume of international trade for all countries for which sufficient data are available. These estimates are said to cover roughly three-fourths of the total world trade. They indicate that from 1929 to 1932 both the imports and exports of North America declined roughly 50 per cent more than did international trade as a whole. From 1932 to 1934, however, the slight gain of North America was about as extensive as for the world as a whole and its gain in exports was better than that of Europe. The great decline in North America's share in world trade from 1929 to 1932 is to a large extent an effect and to a smaller extent a cause of the greater severity of the decline in domestic business in the United States and Canada than in Europe. The fact that world trade as a whole has achieved so little recovery in volume since 1932 in spite of substantial gains in industrial activity within most countries is not surprising in view of the increased tariffs, the foreign exchange and quota restrictions of various countries, the artificial fostering of increased agricultural production in industrial countries, and aid to the development of domestic manufactures in countries not hitherto industrialized.

We have, of course, contributed our share to the handicaps of our own foreign trade through the contradiction between our tariff policy and creditor position, through our domestic price-raising efforts, notably in cotton, and indirectly through a devaluation of the dollar which incited other nations to erect still further barriers against imports in their efforts to protect their balances of payment. In no previous period of business recovery have the handicaps to expansion of our foreign trade been at all comparable in severity with those faced today.

Discussion of the state of our foreign trade suggests the desirability of comparing the current domestic recovery with the course of improvement abroad. We should note in the beginning, however, that on the basis of past experience high conformity need not be expected between the time and character of domestic recovery and expansion in other countries. Recov-

[3] *Review of World Trade, 1934,* (League of Nations, Geneva, 1935) pp. 9-11, 17-25.

ery of the various nations from earlier international depressions has often lacked uniformity. Witness, for example, the wide disparity in both the time and rate of recovery in the various nations from the post-War depression, or from the internationally irregular depression of the 1890's. Although the fact of differences between recovery at home and abroad is, therefore, not unusual, an examination of these differences themselves for any given period may prove instructive.

In comparing the progress of the current recovery in the United States with that in other countries it is desirable to remember that in no other major industrial nation had industrial activity fallen so far from its pre-depression peak. If for each country the number of points recovery in its industrial production index to date be expressed as a per cent of the 1928-29 high, America's record is one of the best. But if the test be the portion of lost ground that has been recovered our showing is comparatively poor. Even in France, whose industrial production is approximately at its depression low, the index for September, 1935, was no further below its 1928-29 level than was that of the United States after thirty-three months of recovery. In Great Britain and the Scandinavian countries the depression decline was mild compared with that in this country, recovery began earlier there than here and was far steadier, and the indexes have been above their respective 1928 levels for two years or more. In most countries which have more nearly reattained predepression levels than has the United States, steel and iron, and construction or war preparation, or both, account for much of the superior performance. Canada, whose decline in industrial production was as severe as our own, has achieved almost the same degree of recovery to date but by means of a far steadier rate of advance. In terms of expansion of employment, too, the record of the United States is thus far one of the most disappointing. In short, not only has our own recovery in this instance been more erratic than in any previous period of which we have record, but it has also been more erratic than the current expansion in any other country.

The general average of commodity prices at wholesale, on the other hand, has gone farther in the United States than in other major countries toward recovering its predepression level. This is true in spite of the fact that the depression decline of prices in this country was more severe than in most others for which price indexes are available.

We may now examine in greater detail the course of the domestic industrial recovery. The upswing since last June is the fourth wave of improvement since the recovery began. The first was the swiftest advance recorded in our entire history. Again using as our criterion Mr. Ayres' index in which trend is 100, industrial production rose 37 points in four months—from 54 in March, 1933, to 91 in July. Gains were registered by most of the constituents of the index, with the greatest rise being scored by semidurable

goods such as textiles, and by semifinished durable goods such as steel. The sharpness of the advance may be attributed to the rebound from the semiparalysis of the period of banking panic, to the rapid depreciation of the dollar in terms of the British pound, to expectation of quick price inflation engendered by the Thomas inflation amendment to the Agricultural Adjustment Act, and to efforts to build up inventories in advance of the sharp increase in manufacturing costs foreshadowed by the prospective NRA codes and the President's re-employment agreement. Once the higher costs under the codes were realized, forward ordering gave place to selling from accumulated inventories. The reaction was accentuated by subsidence of the hopes and fears of an early sharp inflation. The result was a four months' drop of 26 points in the index, a decline equaled in sharpness only by the breaks that followed the panics of 1893 and 1907.

The second period of advance ran from December, 1933, to May, 1934, and carried the index from 65 to 78. The largest contributors to this increase were steel and automobiles, steel orders being sharply stimulated by anticipation of price advances which had been announced for the third quarter. The second reaction, which started in May with declining textile output, more than canceled in four months the entire gain of the preceding six months. Steel production for the third quarter dropped more than 50 per cent, and a reduction of textile schedules which had been voluntary was intensified in September by strikes.

The advance which began with October, 1934, was the first one not wholly or largely canceled by the immediately succeeding decline. With practically every important industry except cement and meat packing contributing to the movement, the index rose from 65 in September to 83 in January, 1935. The ensuing reaction ran less than 6 points to May, after which the index held firmly throughout the summer. Chief among the contributors to this new stability were the maintenance of steel output and the excellent showing of automobiles and woolen goods. Underlying support came from the spending of greatly increased farm incomes for semidurable goods and equipment, from the re-equipment of factories and homes, and from a moderate gain in construction, particularly in residential building.

With September of this year the index began its fourth and current advance, a rise which has been rapid primarily because this autumn the automobile makers, in an effort to reduce the extreme seasonal fluctuation in their employment, began the manufacture of 1936 models in October instead of December. This contraseasonal expansion in automobile output will probably lift the index approximately to 90 for December. If so, industrial activity will at last have duplicated the top figure scored twenty-nine months ago at the culmination of the first spurt of recovery.

Thus, in the third year since expansion began we find industrial production averaging about midway between the depression low and the pre-

depression high. The same proportions are approximately true of factory employment. In the combined field of public and private construction the decline in physical volume from the peak year, 1928, to the low year, 1933, was far more severe than the contraction in industrial production, and the subsequent revival has also been much less. The latest *Bulletin* of the National Bureau of Economic Research[4] contains an estimate of the combined annual volume of public and private construction since 1927, after adjusting for changes in construction costs. This shows total construction in 1933 at 36 per cent of the 1928 volume, with a gain to approximately 42 per cent in 1934. Estimated in the same way, construction in 1935 will probably be 45 or 46 per cent of the 1928 volume. Employment in this field is no doubt proportionately low. The reports of the building trades unions on their numbers employed have ranged during the past year from less than 40 per cent to slightly over 50 per cent.

It has become increasingly clear that if a large portion of the estimated ten millions still unemployed are to find jobs in private industry in the predictable future this country must experience a broad and extensive recovery in the production of durable goods. To an extent even greater than in European countries our industrial mechanism and man power are geared for the rapid replacement and steady increase of the supply of buildings, power and transportation facilities, and durable consumers' goods. If activity in these fields revives, employment in the transportation and service industries will expand. And the increased expenditures of the re-employed will give a further lift to production and employment in the fields of perishable and semidurable goods.

The unique lag of durable goods production is doubtless the result of numerous factors. Such goods appear to have constituted an unusually large share of our total production during the years 1922 to 1929. Many families spent an increasing portion of total income for durable consumers' goods, and could without great hardship postpone for a substantial period further purchases of such items. Not only was the volume of construction unusually great, but much of it was unsoundly financed, and was done at costs higher than were justified even by the then prospective rental values. When depression came, much distressed real estate was thrown upon the market; not only were vacancies abnormally high, but it became far cheaper to buy than to build. A barrier to recovery of construction, one that in the field of housing, at least, has probably come to be most important, is the high real costs of building. During the period of business contraction construction costs declined less than the average of manufacturing costs, less than the average of commodity prices at wholesale, and little more than one-third as much as farm prices.

The rise in prices which occurred in the four months of recovery prior

[4] *Bulletin 58*, November 15, 1935, pp. 4, 6.

to NRA narrowed somewhat the discrepancy between building costs and other prices. If building costs could have remained where they were in the spring of 1933 it is probable that recovery of residential construction would have been considerably greater to date and that improvement in other private construction would by now be under way. The codes, however, afforded the occasion for some rather sharp advances in building costs, and thus erected an additional barrier to recovery. Higher costs and prices under the codes were responsible for similar unfavorable advances in the price of numerous types of capital equipment and of durable consumers' goods.

Probably the most publicized distinguishing characteristic of the current recovery period is the unprecedented extent to which in practically all capitalistic countries, and especially in the United States, the government has attempted to modify the course of business events. This characteristic became increasingly evident under the Hoover administration, but its more striking features have developed during the recovery period as parts of the New Deal. Neither our statistical material nor our analytical techniques are adequate to enable us to offer conclusive proof as to the precise net effect upon business of any given governmental policy. The course of economic activity in general, or in a particular field, is influenced by a number of factors of which the government's policy is but one, and changes are continually occurring among these other influences. We should also recognize that even if the economic effect of a given government action can be shown quite definitely to be detrimental to recovery, it may nevertheless have political justification. A policy may be judged not only by an ideal standard, but by comparison with the policy which, in the social and political situation of the time, would most likely have taken its place.

For example, economists rather generally agree that at the beginning of recovery, with fifteen millions of unemployed, the NRA program of sharp advances in wage rates in selected fields constituted a serious barrier to the desired expansion of employment and production. Yet, if one, perchance, believed that politically the alternative to NRA was a compulsory thirty-hour week with no reduction in total wage per worker one might have looked upon the NRA wage program as a price worth paying. Or, again, the silver policy of the government has been economically incredible, yet some offer in its defense the justification that it has constituted the necessary price of avoiding some form of highly inflationary legislation.

It appears probable that effects of a given line of government action have tended to some extent to cancel one another's influence upon recovery. Efforts under both Hoover and Roosevelt to prime the pump by spending upon public works tended to maintain construction costs which should have declined; on the other hand the funds spent came largely from bank credit expansion and from idle hoards and the secondary spending of the money involved tended to raise the prices of goods that were excessively depressed.

A considerable part of the increase in production and consumption of perishable and semidurable goods has been directly due to federal and state emergency expenditures. This higher level of consumption has stimulated some re-equipping of industry, but the government actions which have induced this expansion have also raised anxieties concerning the more distant future of business, and in so doing have tended to discourage production of the most durable types of producers' goods. Similarly, part of the benefit payments made to farmers under AAA have been collected from urban workers who would otherwise have spent the money for additional goods as promptly as have the farmers. Indeed, the farmers may in many instances have used their checks to pay off loans at the banks instead of buying goods.

A disturbing feature of this recovery, one that for peace-time is unique in our experience, is the extent to which business as it is now operating is dependent upon the emergency spending of government. With ten millions unemployed and twenty millions on relief, it is not yet clear how or when the transfer from government spending to spending by private business is to occur. The various national recoveries in progress are bringing only small increases in our foreign trade, and currency developments abroad appear reasonably certain to grow worse before becoming better. Domestically, the year ahead will bring important Supreme Court decisions, a session of Congress in which numerous bills disturbing to business will at least be vigorously pushed, and an election campaign which gives advance indications of being bitterly waged. The contest between utility holding companies and the government promises to defer re-equipment, and the making of additions to facilities on the part of the rapidly expanding electrical power industry. The substantial gains of permanent character in output per man hour in many industries indicate that the volume of production per capita will need to rise substantially above the predepression level in order to reduce unemployment to small proportions. The rigidity of wages and prices in numerous fields raises doubts as to whether the business system is adjustable enough to accomplish this, especially in the face of the poor prospects for full restoration of our foreign trade. So long as business spending fails to put the unemployed to work, government deficits and inflation threats, thirty-hour bills, and Townsend plan campaigns will probably continue. And while these are present they tend to discourage business spending on durable goods.

Yet the replacement of government spending by business spending may possibly take place sooner and more readily than these pessimistic reflections suggest. If it is valid to assume that price relationships somewhat similar to those of predepression days will prove more workable in the future than would those prevailing in the hectic winter of 1933, then the last two years have brought progress in price readjustment both here and abroad. The commercial banks, in purchasing during the last two and a half years an

unprecedented quantity of federal obligations, have substantially restored the volume of checking deposits. Federal Reserve bank purchases of government bonds, and then dollar devaluation and the related inflow of gold have brought short-time interest rates to astonishingly low levels and have lifted highest grade bonds to new highs. Refunding operations are rising and new capital issues are beginning to appear. Thanks to both federal effort and private business adjustments, mortgage finance conditions are improving. Residential building, though still small, is running more than double that of last year, with good prospects of an equally great absolute gain next year. A potential housing shortage, five years of widespread undermaintenance in industry and in transportation, rising new industries, and improved types of equipment in old ones point to the possibility of a broad and cumulative expansion of production and employment, should the conviction spread that a sustained improvement is under way.

In fact, the chance that within the next few years industrial production will rise to new high levels seems better than the prospect that, if and when such a recovery comes, we shall prevent it from ending in another collapse. Monetary policies pursued in the emergency have provided a basis for a record-breaking speculative boom. The stabilization fund of the Federal Treasury together with the financial needs of the latter will probably, for some time to come, preclude a wholly independent choice of policies by the new Board of Governors of the Federal Reserve system no matter how able and disinterested the men appointed. We have given the Board great powers but without agreement as to appropriate rules of action. The Board cannot know to a certainty what action it should take and when, and restraints are sure to be unpopular when applied. The fact that the banks of this country hold more than 50 per cent of the interest-bearing federal debt adds to the delicacy of the monetary authority's task. The prolonged and widespread suffering imposed by the current depression has probably placed the rank and file in a mood to be intolerant of restrictive actions of a controlling agency that must be based on its own forecast that worse things will happen if it does not put on the brakes than if it does apply them.

DISCUSSION

WILLFORD I. KING: Both Professor Cox and Dr. Lubin are to be congratulated upon the very clear way in which they have described some of the distinguishing characteristics of the present recovery.

From their statements of fact, there can be little dissent. Professor Cox has, however, made one assumption which may be open to question. For example, he infers at the beginning of his paper, that we are now in the thirty-third month of recovery. With this statement, nearly every one will doubtless agree. Is it, however, not possible that this assumption implies a concept of the cycle which is unduly simplified? Does it not ignore the strong empirical evidence that cyclical movements of business in the United States appear to be composites of several or many cycles having different wave lengths and varying amplitudes. May it not be this composite nature of the curve representing economic activity which causes the figures prepared by the National Bureau of Economic Research to indicate large variations in the wave length of "the business cycle"?

The evidence that there has existed in American business a cycle having an average wave length of about forty months is very strong. The why of this wave length is still a mystery. Is it, however, any more mysterious than the why of the twenty-four hour day? In both cases, our belief in their existence depends solely upon empirical observations. In view of past experience, it is not probable that the sharp peak in business in 1933 may best be regarded as the crest of an almost submerged forty-month cycle wave—a wave struggling upward but sadly impeded by the downward movement of one of the longer waves, or perhaps of several waves of different lengths acting in combination? If this view should eventually be proved correct, it would follow that, in so far as the forty-month cycle is concerned, we are not in the thirty-third, but perhaps in the fifteenth month of recovery? Until we come to understand more fully the forces responsible for the cyclical movements of business, the answer to this question is likely to remain in doubt.

It seems to me that both speakers have avoided, unduly, reference to the new money policy existing since March, 1933. Can one legitimately compare price rises since that date here and abroad with increases in production unless those price rises are expressed in terms of gold? Parenthetically, it may be remarked that the implication that the depreciation of our currency affected noticeably the physical volume of our foreign trade would be hard to support with any statistical evidence.

Perhaps I have misunderstood the true purport of their remarks, but it has seemed to me that both speakers have implied that an important force preventing recovery is stagnation in the heavy goods industries. At any rate, several other eminent economists have recently been emphasizing this point of view. In reality, is this not like blaming the thermometer for the cold weather? Professor John M. Clark showed, a number of years ago, that production in such industries as the manufacture of equipment must necessarily magnify greatly fluctuations in the demand for consumption goods.

When the national income shrinks, is it not inevitable that the public will buy

food and other perishable articles before buying durable goods which can be made to last a while longer.

In the beginning of the present recovery, one of the first signs of increasing income was renewed buying of automobiles. Apparently, for the average American, riding in a motor car comes next to eating. As a rule, automobile buying has been accompanied by the building of new homes. However, in this period, residential construction has been a sad laggard. Why?

The answer seems to lie almost wholly in price. Automobile prices have been cut to meet shrinking incomes. On the other hand, residential costs have, until the last few months, been maintained near 1929 levels. Recently, around New York these costs have been cut, and, as a result, residential building is booming.

As a matter of fact, is not price the key to the whole problem of the business cycle? Dr. Lubin pointed out that, during the depression, the real wages of employed workers have risen about 20 per cent. Have we not here the reason for the existence of our army of unemployed?

An attempt has been made in a time of pessimism to market the labor supply of the nation at a commodity wage one-fifth higher than that paid in times of optimism. Is it surprising that the attempt has failed—that, as a result, we have several millions out of work?

Professor Cox has pointed out that this depression has been the most severe on record. Again we find the clew in prices—in the price rigidity described by Dr. Gardiner Means in his address last year. Manufacturers, transportation companies, etc., have tried to market their products—workers have tried to sell their labor—at 1929 prices, entirely oblivious of the fact that the price level has declined and the national income has shrunk. They have held out for these outmoded prices and wage rates more doggedly then ever before. Why?

There are several reasons. First, when the depression opened, corporations were well buttressed with large surpluses. Second, under both administrations, the federal government has used its full power to maintain prices and wage rates. Third, as Dr. Lubin has pointed out, labor unions have been strengthened. Fourth, public works projects have paid wage rates at 1929 levels. And, finally, relief has been poured out in amounts never before even dreamed of, and hence workers have been able to hold out for wage rates too high to clear the labor market.

If wage rates can be kept down while the price level rises in response to inflation, labor will be reabsorbed, production will increase, and, therefore, buying power and national income will expand, more consumption goods will be bought, and automatically the demand for buildings, machines, and equipment will appear. There is, however, no chance that the manufacture of freight cars, locomotives, office buildings, and machinery will move forward until the demand for direct or consumption goods makes imperative the need for these articles.

The only way, therefore, to get out of the depression is to set the idle at work producing the things we really need. When this occurs, there will be abundance of buying power, and business will flourish all along the line.

T. J. Kreps: The paper of Professor Cox has detailed in most interesting

fashion the many singular features of the recovery which has taken place in the United States since March of 1933. We are indebted to him for his accurate and careful measurements, but we should not forget the two sets of assumptions —the one economic, the other statistical—which, he himself has indicated, lie at the basis of his statistical indexes.

The first is singularly important. Any concept of "normal" is at best a matter of judgment. Dr. Cox, in using the well-known business curve of Colonel Ayres, of the Cleveland Trust Company, has thereby made the same assumptions as Colonel Ayres, though these have been recently modified slightly; namely, that the pattern of production in the United States from now on is to be nearly the same as it has been in the past hundred years; that our economic development will continue to require the coal, iron, construction materials (in short, the durable goods) that it required in the past; that the needs of the frontier to which large waves of migration of labor sped in 1837, 1873, and 1895 will somehow be duplicated as they were in 1921 when the automobile and the war shortage in housing combined to force the American economy to gridiron a continent with roads, dot it with garages and filling stations, and spend billions in the construction industry. The frontier needs may no longer exist. The capital-goods industries may go on a replacement basis. Where—precisely where—is there now a need for capital equipment?

It is noticeable that the current recovery is following in many respects the pattern of British recovery in 1921; namely, that gigantic readjustment of international trade and heavy industries are being made. Our indexes with their intercorrelation between heavy goods, as coal, iron, freight-car loadings, may not represent prosperity but a shift in the composition of the national need, or in the means by which a need, as for example, for transport, is met. Similarly, chemical and other developments have made a given physical unit serve considerably greater needs. A ton of coal now means four times the kilowatt hours of energy that it meant in 1914, a fact greatly reducing the freight tonnage of the railroads as well as coal production. The use of small quantities of carbon, vanadium, molybdenum, nickel, etc., has greatly increased the serviceability of a ton of pig iron. In short, the low level of business below the normal of Colonel Ayres' index may measure nothing more than the disappearance of the frontier and the advances in science in the use of coal, iron, railroads, etc.

In the second place, the fact must be emphasized that most of our statistical measurements utilize averages and these sometimes conceal as much as they reveal. They often fail to represent the new highs during the depression in such industries as electric refrigeration, tobacco, rayon, and gasoline. This is particularly pertinent to the observation of Dr. Cox that recovery had taken place more rapidly abroad than here. Looking at the details, we find, specifically, production rising to new levels in Italy and Germany because of military developments, and in England and Sweden. In the latter countries, the fact should be noted that both went off the gold standard in 1931, that they have all the security and labor legislation there which is supposed to scare the magically powerful but timid force known as "confidence," and that in fact they have practically all the control measures that are at present (with the fortunate demise of NRA) to be found

in the New Deal. On the other hand, in countries that have remained on the gold standard, particularly in France and Holland, production, employment, and prices are breaking new lows! In short, averages constitute too frail a reed to support some of the conclusions Dr. Cox appears to imply, particularly those of a political character. These conclusions follow from Dr. Cox's assumptions. But it is my belief that his assumptions of normal, his choice of significant indexes, and the general meaning he imputes to averages, though probably the best available, are at least highly debatable.

PRICE THEORIES AND MARKET REALITIES

By WILLARD L. THORP
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In studying price, we are accustomed to consider the money paid for a certain quantity of a certain quality of a certain commodity in a certain market where only a single price exists. We assume that, apart from differences in cost or effective demand, various purchasers and sellers are not significant individuals but are interchangeable in their relation to the market. Our theoretical and statistical techniques both have required that we eliminate most of the complicating factors. This is most evident in our elementary textbooks, where specific commodities are introduced only as illustrations, and then behave under hypothetical and extremely simplified conditions. Wheat and eggs are the favorites, but strawberries, silver, and sugar beets all have their devotees. One cannot quarrel with this procedure, except that preoccupation over and satisfaction with our economic reasoning under these conditions may blind us to the fascinating areas of queer and strange economic behavior opened up by the very complexities which have been ruled out. Perhaps, just as psychology recognized an area of abnormal behavior whose study in turn illuminated normal psychology, we need to concern ourselves with what, from the point of view of one steeped in economic tradition, is abnormal economic behavior, though the business man finds nothing extraordinary about it.

There are three types of complications which arise in certain industries or markets to disturb one who endeavors to make an analysis of specific price behavior—complications of product quality, of market, and of considerations.

Others have raised the question of quality, so that I need not do more under the first head than suggest that there are several significant types of situations here which may aggravate the problem of price analysis. First there is the change in quality of the item itself, as the automobile or agricultural machinery. While this may not be significant for month to month variations, it may be a dominant factor in any long-run trend, and has definite implications for such problems as measuring relative change between agricultural and industrial prices, or comparing changes in the standard of living over a period of time.

Second there is the multiplicity of style, grade, and size factors for items such as electric percolators or women's shoes, with the resulting problem of shifting differentials or shifting weight of various subdivisions in the aggregate. It should be kept in mind that in many cases where there are numerous types and grades of items sold by the manufacturer, as for example, electric sockets, not only will there be occasional broadside price changes affecting the entire list, but there are continual sharpshooting

changes in the list price of one or another single item. The most difficult cases of this type are the "tailor-made" prices, where the price is computed on the basis of a peculiar combination of elements defined by the buyer, as for example, most construction projects, or special mixed fertilizers, or rubber covered building wire.

Third is the continual introduction of new lines and withdrawal of old ones. Thus, a significant development in domestic electrical appliances during the last several years has been the introduction of cheaper and presumably inferior lines, although the older standard products are still continued. The disturbing character of this in certain lines is indicated by the fact that the price ratio between the best and the cheapest electric curling iron exceeds 30 to 1. Whether or not the offering of the new, cheap product represents a lowering of price, depends of course upon the question that is being asked.

The result of all these brief comments on quality is to indicate the extreme difficulty of making any analysis of price behavior over time, unless the product is simple and standardized, like sugar or eggs. Even in the case of eggs, I suspect that one might find the quality problem appearing as between brown and white shells, and cold storage and fresh. It is even conceivable that physical and chemical analysis might find significant changes in egg content over the last decade.

The second complexity—the development of customer classes—is one which has become greatly increased during recent years. In fact, markets appear to vary all the way from those with a single price to all customers to those with a different price to every customer. Many industries have customer classes, with differing rates of discount from a single list price. These may vary from the simple retailer-wholesaler categories to the thirty-nine customer classes found in the flexible cord industry. The discount structure may group customers by function, geographical area, quantity of business, method of purchase, or any combination of the four. While the usual concept of the quantity discount relates to the economies in connection with individual transactions, in many industries it is applied to total annual purchases, and is clearly used to distinguish a certain group of customers rather than as a means of adjustment for economies arising from specific large-scale transactions. In the case of fertilizer materials, the quantity discount is based upon the season's purchases by the buyer from all the members of the industry.

A simple case illustrating the result of customer differential discounts is that of a company selling flashlight cells. Some months ago, its list price and discounts yielded the following series of prices:

List price	10.0	cents
To retail dealers	6.5	"
To department stores	5.5	"
To wholesale jobbers	5.0	"

To industrial users:	
Less than 5400 annually	5.5 cents
More than 5400 annually	5.0 "
To manufacturers of battery consuming devices	4.5 "
To toy manufacturers:	
Less than 250,000 annually	3.0 "
250,000–500,000 annually	2.75 "
More than 500,000 annually	2.5 "

In addition, prices varied according to the use of the standard label or a private label. The above price list is for the standard label. The identical standard battery sold to the chain store for 5.5 cents is sold to them under a private label for 2.75 cents.

Another type of customer situation is the fractional horsepower motor industry which has a discount structure based upon nine customer classes. The larger purchasers fall in Class G. However, in this group, many of the customers have "individual multipliers" which represent their discounts beyond that allowed in general to those in Class G. In addition, there are quantity discounts, based by various members of the industry on criteria such as dollars in the order, numbers of motors in the order, total dollars purchased during the year, number of motors purchased during the year, and at least one member of the industry allows the quantity discount according to purchases from all members of the industry during the year. In other words, for most customers, there is a general classification, but the larger customers have individual and different discounts, based apparently upon the most that each can get from any member of the industry.

To make perfectly clear the behavior of this type of price structure with customer differentials, let us consider in some detail the actual price history of one manufacturing company with respect to one type of flexible cord over a period of thirteen months (some members of the flexible cord industry would show wider variations, others less):

September 7, 1933. List price $11.00 per thousand feet. Discount 10 per cent to jobbers and wholesalers, and manufacturers and chains with warehouses on purchases of more than 50 M feet. A relatively simple structure.

October 9, 1933. List price advanced to $24.00. Discount of 40 per cent to dealers, central stations and contractors; 48 per cent to purchasing service companies on manufacturer's billing; 50 per cent to purchasing service companies on their own billing; 58 per cent to manufacturers taking less than 50 M, to Class B chains, to United States government, to railroads; 60 per cent to manufacturers taking more than 50 M, jobbers and wholesalers, and Class A chains; 65 per cent to wiring device manufacturers. This step represents the development of a widely differentiated functional discount.

December 21, 1933. Only change is increased discount to manufacturers taking more than 50 M from 60 to 65 per cent.

January 3, 1934. List price reduced to $18.00. Discount to jobbers and wholesalers 60 per cent. To all other buyers, based on quantity as follows: buyers less than 10 M, 52 per cent; 10 M-49, 55 per cent; 50 M-200 M, 58 per cent; more than 200 M, 60 per cent. Here is almost a complete shift from customer classification to a quantity discount basis.

January 25, 1934. Flat discount to all buyers of 60 per cent. This is the abandonment of all differential discounts.

February 14, 1934. Added extra 5 per cent discount to all distributors, wiring device manufacturers, and other manufacturers taking more than 50 M. The necessity for customer differentials emerges once more.

February 28, 1934. Manufacturers taking less than 50 M reduced to 58 per cent and those over 50 M to 60 per cent.

March 15, 1934. List price reduced to $9.00. Discount of 5 per cent to jobbers, mail-order houses and national syndicates and to manufacturers requiring over 100 M; an extra 5 per cent to distributors to manufacturers. Since the list price is reduced by 50 per cent, the differentials are reduced, even though the percentage remains the same.

April 7, 1934. Discount of 10 per cent to all buyers of more than 500 M. Here is an overall quantity discount once more.

From the record one can draw certain general conclusions—for example that in September, 1933, the net price ranged among customers from $11.00 to $9.90; that in October, it ranged from $14.40 to $8.40; that for two weeks at the end of January, 1934, it was $7.20 to all; and that in April, 1934, it ranged from $9.00 to $8.10. But one must start making assumptions to develop any more exact measure. The real significance of the illustration lies in the degree of flexibility in the price structure. While few industries probably have shifted the basis of their prices as rapidly as did the flexible cord industry, the illustration is not unique. Changes of the type and character here shown appear in the records of many industries. Some evidence of importance is indicated by the large number of cases where the National Recovery Administration was urged to establish mandatory customer classifications.

The above record is merely the story of one type of flexible cord carried by this particular company. Separate prices and discounts prevail for radio wire and Christmas wire, which it also carries, as well as occasional temporary price concessions to certain customers on certain special types of wire. Furthermore, the story of customer discounts given above is only part of the picture of this manufacturer's price problems. The same company varied from time to time the amount of extra charge for eight special types of braid. During this same period, the terms of payment were changed from 2 per cent 10 prox., net 25 prox. to 2 per cent 10 prox., net E.O.M. prox. The standard packaging on some types of cord was changed from 500-foot spools to 250-foot spools, and the special quantity discount on factory lengths was increased from 40 cents per M to 60 cents per M.

These last notes illustrate the third type of complexity which must be recognized—the considerations. We all too often think of five-cents-for-an-orange as our typical transaction. But the more usual business transaction involves cash discount and credit terms, freight and delivery terms, special service discounts or charges, and any number of items relating to special industry charges or concessions such as advertising allowances, container extras, rental or leasing plans, and special label or design charges or allowances. We have frequently regarded these items as relatively unimportant and inactive, but the generalization cannot stand unchallenged. In the case of the magnet wire industry, for example, the base price is directly related to the price of copper and moves only as and in proportion as it moves. During a recent six-months period, there was only one change in this base

price. However, in the same period for one typical company, there were three changes in cash and credit terms, two in the quantity discount, and six in the character of freight allowance. In addition, as an invisible element not apparent from the actual price lists, the "point of shipment" from which certain classes of purchasers had to pay the freight referred to nine places at the beginning of the period, while at the end there were forty-two. Nor are these considerations always simple conditions applying generally through the industry. In the battery industry, different specific products and different classes of customers have different arrangements as to freight; so that the result is a most elaborate and confused delivery charge and allowance structure. A single manufacturer producing a number of different electrical products, may have a dozen different sets of cash and credit terms, according to the division of the industry in which each product falls.

We are accustomed to make our theoretical and statistical analysis in terms of overall forces which operate in a market, raising or lowering a single price. But the type of industry which I am describing does not have a single price. It sells in many markets which are only partially related, if at all. Price changes creep through the structure gradually. In each industry, certain groups of customers and certain types of considerations seem to be much more flexible than others. The business man does not cut his price in general, but rather in a particular situation where he can clearly hope for a sale as the result. Frequently, this can be done by splitting off a new customer class from an existing one, and granting it a larger discount. This operation of prices for classes of customers may in fact lead to greater price flexibility, for it permits the seller to make a price change without squarely facing the fact of a general price reduction. However, at the same time, it creates price differentials which may have serious implications for the less favored and weaker buyers. Frequently, the same result of widening differentials occurs from the less obvious procedure of using the considerations to favor certain groups—for example, granting advertising allowances to certain selected customers, or broadening the quantity discount.

Lack of information concerning specific price behavior makes it impossible to estimate how large a percentage of our goods and services pass through markets of the type here indicated. These problems are of great importance in such widely varying industries as fertilizer, coffee, underwear, automobile tires, furniture, and many branches of the electrical industry. They appear in connection with the price of electricity, the size of doctor's fees, and railroad rates. Our price indexes have tended to cover those cases where the price structure is relatively simple. Present information is sufficient to demonstrate that the cases of complex price structures are important enough to make it rather difficult for us to disregard them with a gesture of unconcern.

The above illustrations are not intended to do more than indicate some

of the complexities which appear when one examines the internal price structure of certain industries. They challenge the significance of much of our statistical work in its present form—both as depicting price trends and price flexibility. Perhaps nothing can be done about it, and I know that those working with the data are aware of these weaknesses. But list prices certainly give no accurate picture, being merely of significance as a basis on which computations are made. Even list prices with corrections for certain simple discounts are inadequate in many of the cases which have been examined.

The statistical measurement of price behavior in these industries requires at least three special techniques. The first is to find a method of summarizing the numerous products which are included, realizing that they may change their character and importance rapidly. As illustrations, consider the problem of measuring prices for ladies' dresses with their variations in style and materials. Or consider the treatment of the electric toaster industry when, without changing the price structure on existing lines, manufacturers turn out a new and cheaper product for mass distribution.

The second problem is to find a method of incorporating in the record the many items of consideration, such as delivery terms, installment purchase arrangements, cash discounts, and the like, as well as to correct for changes in the quality of the product itself. The most difficult single item to incorporate is the quantity discount set-up, since its effect on the price is actually a variable. But these are just as much changes in price as the more usually considered list price.

The third difficulty is that, with so many different prices for a given product all in existence simultaneously, a shift in the quantities moving through various channels of distribution results in an actual change in the net price to the manufacturer. In some industries, the price to certain customers is double that to others. The large purchasers, who usually receive the maximum discounts, have increased their share in the total purchases in recent years. Even though this may not have changed the price structure at all, it has greatly reduced prices.

These difficulties can be partly solved by establishing a series of hypothetical transactions and computing net prices under varying sets of circumstances. However, even then, no accurate summary can be attained without detailed information concerning sales to provide a basis for weighting. In some cases, data would need to cover sales by channels of distribution, by size of order (or whatever the basis of quantity discount might be), and by geographical area.

At present one cannot say more than that the results might lead to some modification of our conclusions concerning price trends and price flexibility. Since probably both quality and mass distribution have been advancing, recognition of their influence would presumably indicate some reduction

in prices of products in industries of the type here discussed. Furthermore, it would show many cases where an apparent inflexibility was in fact limited to the area of the price contract covered by the data employed, and considerable variation took place in the other elements in the bargain. Examination of the total picture indicates that the recognition of the complexity of the price contract involves also recognition of the extreme difficulty of controlling a total price structure. It is a bit like squeezing a balloon—it can break through one's control at any point.

Many of the difficulties would disappear if one could assume that the various elements in the internal price structure of any industry were adjusted by the general forces in the market; so that any differentials existing corresponded to actual differences in economic services received or rendered. That this is not necessarily the case is indicated by the character of the variations of the differentials. Where prices behave as in the flexible cord illustration, it is difficult to see any considerable adjustment to costs or services. Nor does competition always permit free experimentation on the part of the business man. Consider, for example, the matter of cash discounts. If some significant member of an industry grants a cash discount of 10 per cent, the others in the industry must follow his lead or they will lose orders. Perhaps the result is to reduce income so that some manufacturers are forced out of the industry, but there is no force present which operates directly to bring this excessive rate back into line. Even though most of the industry regard it as absurd, they must meet their competitors' quotations. The discount for cash now enters into cost as part of the basis upon which the industry must operate, and is just as impervious to individual attempts to reduce it as taxes. And if and when the demand is so great that buyers are offering concessions, there is no particular reason why they should select reductions on the cash discount item rather than any other to win delivery from sellers. Or consider the relationship between customer classes. One can assume that the functions performed, or the service concessions obtained, by particular groups of customers do not change frequently or extensively. Nevertheless, their price differentials seem to be very flexible in some industries. Nor are the controlling economic forces at all clear. It is difficult to demonstrate that a non-economic quantity discount is necessarily self-destructive. If an excessive class discount is given to some particular group, it does not necessarily start forces which will correct that particular item, although it may put a pressure on the total structure, which may eventually lead to an equilibrium based upon a compensating error at some other point. This is particularly true when the customer groups are not directly competing in their own markets, as for example, the department store and the toy manufacturer purchaser of flashlight batteries.

In the field of labor, two steps in wage theory exist; the first, the gen-

eral wage theory which defines certain limits within which variation may be found, and the second, a recognition that the actual determination within these limits is a matter of bargaining power. The same point of view is perhaps necessary in the field of price differentials. In some industries certain classes of customers appear to be able to command discounts whose relationship to other prices cannot be fully explained by any economies or services rendered, but only by their bargaining strength. In some instances, large purchasers receive a series of concessions, no one of which may seem excessive, but the total accumulation may be considerable. The customer classification is based in part upon size. Add to this a quantity discount. Freight allowances may vary with the size of the order. Special promotional discounts or advertising allowances go to large distributors, etc. The net result is to create differentials whose excessive character is not effectively corrected by any set of economic forces which operate on them directly, but may be eventually offset by compensating burdens placed upon weaker groups, either directly or by a generally higher level of prices, with the wider differentials persisting.

Another interesting implication of all this is that the purchaser is not able to express his desires effectively in a complex market. His choice lies between one complex set of conditions and another equally complex. It is like voting for president when the choice requires a compromise on many issues. Approximately the same product is offered by one manufacturer with one set of credit terms, delivery allowances, functional and quantity discounts, and by another manufacturer with quite different arrangements. The customer must take the entire structure of one or the other. Manufacturers themselves may be unable to determine the specific element in their structure which attracts or loses their customers.

The above discussion is not intended to lead to any final conclusions. The information about the behavior of internal industry price structures is too scanty. However, it should expose an area for study and consideration which offers fascination and excitement. We have many students engaged in examining the national price structure as depicted by composite and simple product indexes. But price behavior in industries with complicated product or market structures within themselves is a field still awaiting exploitation. And from the analysis of the strange and curious behavior of such prices, we may be led to modify some of our statistical conclusions and theoretical concepts based thus far on simple industry situations.

NOTES ON INFLEXIBLE PRICES

By Gardiner C. Means
Department of Agriculture

The increasing discussion of the importance of inflexible prices in the American economy has been somewhat stimulated by previous articles by the present writer. In one of these, material was presented on inflexible administered prices and their importance for monetary policy.[1] This same material with its implications for industrial policy was contained in a confidential report to Secretary Wallace which was commandeered by the last Senate and published as a Senate Document.[2]

The present article attempts to bring up to date the material on prices, to clarify its meaning, and to further indicate its implications. The first section will present price indexes which show the difference in price behavior of flexible and inflexible prices in a period of business recovery. These series have particular relevance to the question of money inflation. The second section will discuss the validity of these figures in the light of criticisms which have been leveled at the earlier figures. The final section will take up the implications of inflexible prices.

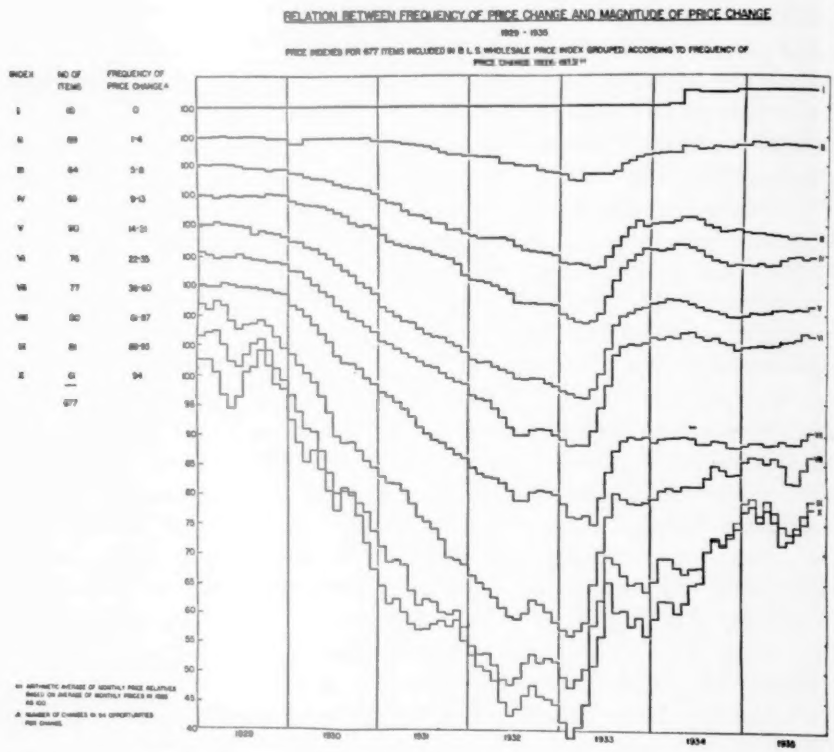
In the previously published papers on inflexible prices, the results derived from applying a new type of analysis to the best available supply of wholesale price data were reported. This new approach consisted of taking a series of price data for an individual commodity and counting the number of price changes in a given time period. This approach was applied to the bulk of the items underlying the Bureau of Labor Statistics Wholesale Price Index. The number of times the price of an item changed over its price in the previous month was counted for an eight-year period. This gave a basis for classifying items according to frequency of price change. The price of some items changed every month. The price of some items did not change a single time in eight years. Other items were intermediate in frequency. Half of the items could be classed as having a low frequency of price change, each item averaging less than four price changes a year. To a surprising degree, this body of wholesale prices reported to the Bureau of Labor Statistics showed infrequent price changes. It did not show the constantly fluctuating prices which have traditionally been associated with a free market. Even more striking was the fact that during the decline in business activity from 1929 to early 1933, the prices which tended to change less frequently also tended to fall less during the depression. This suggested that the frequency of price change could be used to segregate price series into groups which would reflect essential factors in the price situation.

[1] "Price Inflexibility and the Requirements of a Stabilizing Monetary Policy," *American Statistical Journal*, Vol. 30, No. 190 (June, 1935), p. 401.

[2] "Industrial Prices and Their Relative Inflexibility," Senate Document 13, 74th Congress, First Session.

Following this idea, the bulk of the items in the Bureau of Labor Statistics wholesale price index were segregated into ten groups according to frequency of price changes and an unweighted price index computed for each group. Since presenting those indexes, I have reworked the list of items to eliminate certain items of questionable usefulness or of questionable accuracy and have computed the indexes for the period of economic recovery. In doing this I have had in mind particularly the question of

CHART I

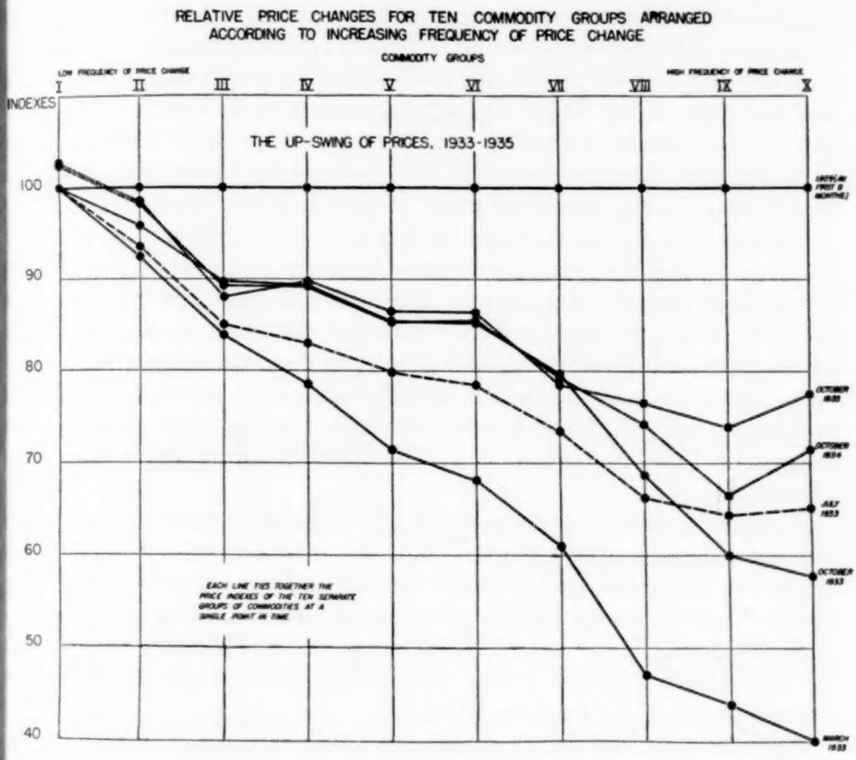


inflation. It has not been possible to recompute the price indexes for the ten groups from 1929 to 1933 on the basis of the revised list of items, but I have ample evidence that the indexes for that period would be altered in detail only. For this reason I have spliced the revised indexes for 1934 and 1935 onto the unrevised indexes for the earlier period and the results are presented in Chart I.

In Chart I, the indexes are arrayed in order of increasing frequency of price change. The first nine months of 1929 are used as 100 in each case and to prevent the different indexes from falling on top of each other the

scale for each successive index is placed five points below that of the preceding index. This means that if all the indexes fluctuated together (and the same amount) they would remain an equal distance apart. By examining the chart you can see that during the depression the indexes representing prices which changed frequently dropped very much farther. Likewise, and this is important, the flexible prices have moved upward most in recovery. As a result, prices have come very much more into line with the

CHART II



relationships existing in 1929 than was the case at the bottom of the depression.

This is much more clearly brought out in the second chart. Here the ten groups of items are represented in order with the most inflexible items represented on the left and the most flexible items on the right. The positions of indexes for the ten different groups at different dates are represented by dots, while lines connect the dots relating to a single date. The first line is for the average for the first nine months of 1929. It is the 100 line. The bottom line reflects the position of prices in March, 1933, when

most of the indexes reached their bottom. Essentially it shows the extent to which prices in each group dropped during the depression. Thus, the first group did not drop at all. The tenth group dropped approximately 61 per cent. The dash-dot line reflects the position of prices for October, 1934, and the dotted line reflects their position a year later, October, 1935, the latest date for which the data have been compiled.

Perhaps the most striking aspect of these charts is that relating to the question of inflation. While the term inflation is a word of many meanings, it is very frequently used to refer to a rise in prices which is harmful or objectionable. Without attempting to define inflation let us consider just what kind of price increases would be harmful or objectionable.

There seems to me to be one kind of rise in prices which is desirable and two types of rise which would be objectionable or harmful. The desirable kind—desirable because it would bring the individual elements in our price structure more nearly into balance—would be a price rise which was shared by individual groups of prices roughly in proportion to their depression drop. Such a price rise would reflect itself on this chart (Chart II) in a pivoting around the inflexible prices. Up to the point where the flexible prices were brought roughly into line with the inflexible prices, such a pivoting price rise would have the effect of removing an important part of the price maladjustments which developed during the depression. However, a pivoting price rise which carried a significant distance through the horizontal, i.e., lifted the indexes of flexible prices seriously above the indexes of inflexible prices, would be likely to bring other price maladjustments.

A second type of price rise which might be harmful would be one which did not represent a true pivot. Thus, the intermediately flexible prices might rise while the flexible prices did not, giving a hump to the index line on Chart II. Or the flexible prices could outrun the semi-flexible prices giving the index line a U-shape. A smooth pivot up to the horizontal (Chart II) would seem to be the process of restoring price balance. A rise beyond this horizontal might be disorganizing.

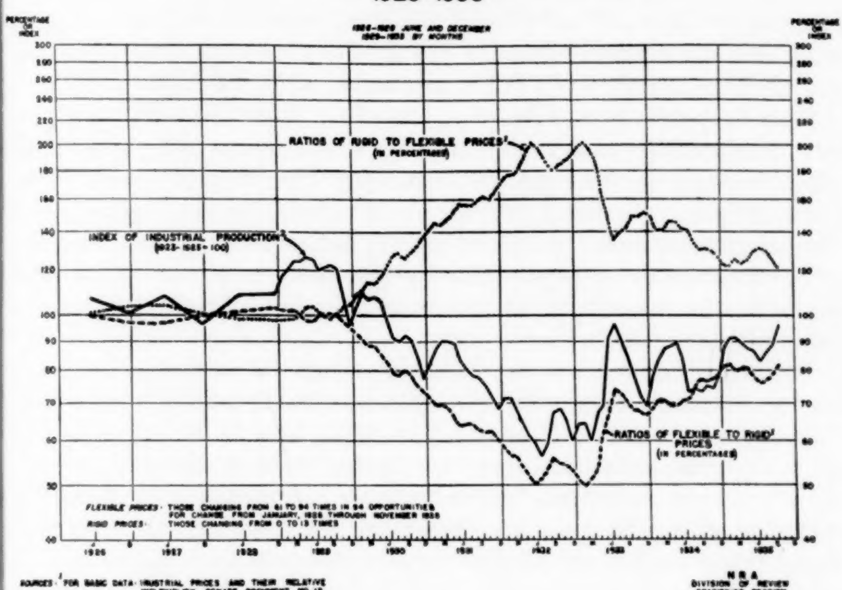
It should be noted that in suggesting a smooth pivot to the horizontal, 1929 price relationships are being used as though they constituted a balance to which it was desirable to return. This is, of course, an assumption which is justifiable only as a rough first approximation. Relationships between flexible and inflexible prices may have been seriously out of balance in 1929—though price behavior in 1929 and the years immediately preceding was not such as to suggest serious unbalance. Likewise, even if price relationship in gross were in balance in 1929, changes in demand or in supply might have changed the relationships which would constitute price balance in 1935. Both of these matters deserve serious attention. However, it is probable that the 1929 relationship constitutes a fairly good,

crude, first approximation to balance, not between individual prices, but between groups of flexible and groups of inflexible prices. Presumably a better rough indication of balance could be worked out.

In the charts, two things stand out with respect to the rise of prices since 1932. First, the rise has been a fairly smooth pivot. And second, neither the amount of rise nor the speed of rise in the last year suggests serious danger of shooting through the 1929 relationships. The pivot has carried prices back only half of the way from the bottom of the depression, while at the

CHART III

RATIOS OF FLEXIBLE TO RIGID PRICES AND INDEX OF INDUSTRIAL PRODUCTION 1926-1935



rate of motion of the year from October, 1934, to October, 1935, it would take approximately four years for the flexible groups of prices even to reach the 1929 balance, let alone surpass it, while the six intermediate groups of prices have hardly moved from their position of two years ago. Surely anyone who says that prices are rising too rapidly or are getting out of line has a heavy burden of proof to bear. Inflation in that sense has certainly not been taking place nor does it look imminent.

This does not mean that vigilance should not be exercised to prevent a harmful price rise, but rather that the price rises which have taken place to date should not be a cause for apprehension. More of the same kind of

rise is called for if flexible prices are to be lifted into line with inflexible prices.

Not only have prices in the upswing been behaving in an appropriate manner, but there appears to be a close relationship between industrial activity and the extent to which flexible and inflexible prices are in line. Mr. Von Szeliski, of the Research and Review Section of the NRA, has worked up from my figures an index covering the 222 most frequently changing prices and compared this with an index for the least flexible 217 items. He then compared the result with the Federal Reserve Board index of physical production. When the flexible prices fell away from the inflexible, industrial production fell in almost exactly the same proportion. When the flexible prices approached the inflexible, industrial production increased in much the same proportion. This relationship is clearly shown in Chart III. It would seem to be consistent with and lend some support to the idea that a depression can be described as a fall in prices at the flexible end of the price scale and a fall in production at the inflexible end.

Since the publication of the price data of the above character, there have been certain criticisms as to their validity which deserve discussion. These criticisms fall into three groups. First, there are those who question the picture of price inflexibility presented in the charts. Second, there are those who accept the statistical picture as roughly accurate, but question the interpretation which the present writer has placed upon it. And finally there are those who accept both the picture and the interpretation but question the implications which I have drawn.

The first question has to do with the accuracy of the statistical material. Do the Bureau of Labor Statistics figures accurately reflect actual prices? It has been held that the Bureau's price series have to do with list price, not with actual price. However, the Bureau of Labor Statistics asks for and usually gets net prices. Where there are list prices this means the list prices less all regular discounts. Presumably the resulting price quotations do not reflect unusual special discounts. In some cases, errors undoubtedly creep in. In examining a considerable number of the Bureau's price series involving inflexible prices, I have become convinced that the bulk of their quotations represented net prices. The exceptions seemed unlikely to falsify seriously the picture which I presented. Consultation with the technical staff of the Bureau of Labor Statistics supports this view. So far as this question is concerned, I am confident that the statistical picture is not seriously faulty.

A second line of criticism has more validity though it is doubtful if it has great significance. For many items, the terms of sale other than discounts can also be altered. Thus, longer terms of credit, greater freedom to return damaged goods, and a host of other items bring changes which may be equivalent to changes in price. The real problem, however, is not whether

they bring the equivalent of a change in price but whether they bring the equivalent of a significant change. There is a good deal to indicate that the influence which these changes exert is, with perhaps a few exceptions, equivalent only to that of minor variations in price and is not sufficient to produce a significant change in the indexes for the different groups.

That these criticisms do not affect the basic picture can be clearly brought out in connection with agricultural implements. Of the figures I have published, those on agricultural implements have received the most criticism. The previous articles pointed to the depression drop in agricultural prices with production maintained and the depression drop in agricultural implements production without a significant drop in price. The actual figures published were:

	Drop in price in per cent	*Drop in production in per cent*
Agricultural implements	6	80
Agricultural commodities	63	6

In this connection, critics pointed out that the Bureau of Labor Statistics price index for agricultural implements showed several points greater drop than the above and further held that even the Bureau of Labor Statistics index did not sufficiently reflect the true decline in price. Fortunately, the Bureau of Labor Statistics, in carrying out its program of price data revision, selected agricultural implements as one of the first groups to be studied. The review of the price series and of the method of compiling the index was carried out under the careful direction of Dr. Cutts. Conferences were held between representatives of the Department of Agriculture, the Department of Labor, the Central Statistical Board, agricultural implements manufacturers, implement dealers, and farm organizations. There was general satisfaction with the results; so that we can accept the revised index as having met the two criticisms registered above as well as any index can. Although this index showed a larger decline than the index I used, the picture of price and production changes, remains essentially the same. Between 1929 and 1933 the changes according to the revised index were as follows:[3]

	Drop in price in per cent	*Drop in production in per cent*
Agricultural implements	15	80
Agricultural commodities	63	6

The great difference in the effect of the depression on flexible priced and on inflexible priced industries is made clear. And the question must still be

[3] The differences between the index of agricultural prices used in the earlier price studies, the earlier Bureau of Labor Statistics index, and the revised Bureau of Labor Statistics index are almost entirely due to differences in the items included and in the weights given to them. A major part of the change comes from the greater weight given to tractors.

asked: "Why did prices go down so little in an industry with infrequently changing prices, when production so nearly disappeared?"

A third criticism, this time of considerable importance, has to do with changes in technology of production and in quality of product. Both the labor and materials which a commodity represents and therefore its quality can change with time so that even the net price does not apply to a constant item. This fact presents a most difficult problem in price analysis.

Presumably, a price is a ratio between an amount of money and an amount of some particular commodity. But unfortunately, the amount of any particular type of commodity can be measured in many ways. The ways most important for the present discussion are, first, in terms of the amount of labor and materials going into the commodity; second, in terms of units of particular physical characteristics; and third, in terms of the amount of work or use that can be gotten out of it. These different types of prices can be most clearly brought out in the case of services, though the different types of price quotation can equally well occur in the case of goods.

Thus, a farmer may contract with his neighbor to do so many tractor hours of plowing in his fields. Here the commodity "plowing" is measured by the first method, i.e., in terms of what goes into it (tractor-hours), and the price of plowing might be stated as so many dollars a tractor-hour of plowing.

If the farmer contracted with his neighbor to plow so many acres of land, he would be measuring the commodity by the second method—units of physical characteristics—and the price of plowing would presumably be stated as so many dollars an acre of plowing.

Finally, the farmer might measure the commodity "plowing" by what he would expect to get out of it. Thus, he might contract with his neighbor to plow enough land to grow so many bushels of corn (under normal conditions). In this case, plowing would be measured in terms of expected usefulness and the price could be stated as so many dollars per bushel-of-corn's-worth of plowing. For purposes of further discussion, I will distinguish between these three methods of measuring a commodity by referring to them as measurement by contribution, measurement by physical characteristics, and measurement by performance.

Because of these three methods of measuring the amount of plowing, all equally legitimate, it is possible to get three different ratios representing price. Of more importance for our discussion, it is possible to get quite different changes in price depending on which method is used. Thus, suppose that the neighbor was paid exactly the same amount for plowing exactly the same field in two successive years and that he required exactly the same number of tractor-hours to do it but that in the second year the quality of his plowing was better, so that a higher yield of corn per acre could be expected. In this case, the contribution price and the physical price would

have remained the same, yet the price per bushel-of-corn's worth would be less. In one sense, that of performance price, there has been a drop in price even though in the two other senses there has been no change. Here the equivalent of a change in physical price has occurred even though physical price has remained the constant.

Or take another case. Suppose that the neighbor was paid exactly the same amount for plowing exactly the same field in two successive years and that the prospective yield (so far as it was affected by plowing) was the same, but that in the second year he has improved his technique in handling the tractor so that it took him a smaller number of tractor-hours to do the job. Here both the physcial price and the performance price would have remained the same but the contribution price would have been higher. The plowman gave less hours of his own and the tractor's time for the same amount of money. In one of the three senses, that of contribution price, the price has gone up while in the other two senses it has remained constant. Here also the equivalent of a change in physical price has occurred though physical price has been constant.

In most usual practice and in the practice of the Bureau of Labor Statistics, the prices used are the physical prices. Yet the two examples given above suggest that improvements in quality of product may be considered as equivalent, in a sense, to a lowering of physical price, while improvements in production techniques may be considered as equivalent, in a sense, to a raising of physical price. This means that physical price indexes may not be adequate measures of price changes. Perhaps the physical prices should be adjusted for changes in quality of product and for changes in production techniques.

Just what would such adjustments mean? Here, also, some work has been done in connection with agricultural implements. Three recognized agricultural engineers made a most careful comparison between standard agricultural implements as they were produced in 1910-14 and the corresponding implements produced in 1932 and listed all the changes in quality. The engineers then constructed a single index of quality for such items to reflect these changes. No indication was given in their report as to how the index of quality was arrived at from the list of physcial changes, nor have I been able to discover the methods used; so the meaning of the index is not very clear. However, it is accepted as authentic by certain more important agricultural implement companies and so we can fairly assume that it has not seriously underestimated the improvement in quality during the twenty-year period. According to the indexes, the quality of the agricultural implements covered improved on the average approximately 67 per cent in twenty years or at the rate of 2.5 per cent a year. Just how much improvement actually took place from 1929 to the spring of 1933, the study does not show, but the indications of the study are that the improvement has

been fairly steady throughout the twenty-year period, so that this average rate of improvement would give an approximately accurate picture. If we were to assume that this rate of improvement continued through the depression, the improvement in quality from 1929 to early 1933 would have been approximately 8 per cent. If this were the only adjustment made to the net physical price index, the revised Bureau of Labor Statistics index for agricultural implements would have been lower by seven points (8 per cent) giving a depression drop of 22 per cent. However, such an index would take no account of improving techniques of production. If adjustments for improving quality of product are to be made, logic requires that adjustments for improving production techniques should also be made, and since these would operate in the opposite direction they would, to a greater or less extent, counterbalance improvements in quality.

Unfortunately, the engineers have made no index of contribution (manpower, materials, etc., used) comparable to their index of quality. How much have production techniques improved? Surely the engineering force which has improved quality so greatly has not failed to bring about improvements in techniques of production so as to save both materials and labor. When improvements in techniques of production are offset against improvements in quality of product, is there any reason to think that the price figures published by the Bureau of Labor Statistics would be altered in a significant manner by adjustment for both factors? This is a matter which certainly should be investigated, but I doubt if the net effect of a full adjustment would significantly alter the relational picture I have presented.

A second type of criticism has arisen from those who accept the statistical picture as essentially correct but question its interpretation. In part, this criticism has rested on a confusion between three types of things which are frequently said about prices. Prices may be attacked on the ground that they are unfair. They may be attacked on the ground that they are unbusinesslike. They may be attacked on the ground that they impede economic functioning. The whole thrust of my discussion of inflexible, administered prices has been directed toward the third of these attacks.

So far as unfairness is concerned, a great many industries could be cited in which prices have been administered and have dropped little during the depression, yet in which profits have entirely disappeared. Where this has happened it would seem to be hardly relevant to talk of unfairness of price; i.e., of prices which bring unfairly large profits. Yet it is exactly such industries which present the main problem with which I am concerned.

Many people have held that the businesses whose volume of sales declined greatly during the depression yet failed to lower prices significantly were failing to exercise good business judgment. The idea is that the volume of sales for the individual business would increase sufficiently to make up for the lower price. While there are undoubtedly instances where failure to

lower prices constituted unbusinesslike action, for the bulk of inflexible, administered prices the policy of holding up price even though volume declined has been the only sound business policy for the individual enterprise acting independently. There are too many situations in which the net income of the individual enterprise would have fallen as a result of lowering price, to put much stock in the idea that failing to lower price is presumably an indication of poor business policy. The net income on the increment on sales due to lower price all too often would not make up for the loss in income due to the lower price on the sales already in prospect. It is of the utmost significance to me that the inflexible, administered prices are in most cases the best possible business policy for each of the separate and isolated enterprises of industry.

The main point in the earlier documents is that inflexible, administered prices have acted as an impediment to that automatic readjustment which is supposed to occur through price change and which is supposed to keep our economy in approximate balance with full use of our economic resources. Traditional economics has taught that when each individual or enterprise independently seeks its own interest and makes its policy accordingly, the net result will be an effectively functioning economy. Is it not probable that in the presence of inflexible, administered prices the opposite is more nearly true? Where power to administer prices rests to a significant extent in the hands of individual business enterprises, must not the net result of policies made separately by individual enterprises necessarily be an ineffectively functioning economy? With the fairest of possible prices and the most realistic and well-informed business policy, so long as the power to administer prices to a significant extent is exercised by individual enterprises and reliance is placed on price adjustment to maintain effective economic balance, will not the economy be in constant state of serious unbalance except as it is for a moment in balance passing from a state of unbalance in one direction to a state of unbalance in another direction?

Means' approach to inflexible prices

The sharp conflict between the traditional picture and the facts of business policy under present conditions can be traced to a single basic assumption. The traditional picture of automatic balance rested on the basic assumption that the individual producer had no control over price—that he faced a horizontal demand curve. This meant that on the one hand if the individual producer set an offered price above the market, he would make no sales; on the other hand he would never have occasion to offer his product below the market because, within his power to produce, the market would absorb all he could offer at the market price. Such was the condition in most of agriculture before the AAA. The same condition exists in important industries, such as clothing, bituminous coal, etc.

But to a major extent, technology and economic concentration have brought a change in the demand curve faced by the individual producer.

In a great body of cases he faces a demand curve which slopes up to the left. He has an actual choice between lower price and larger volume of sales on the one hand and higher price and smaller but still significant sales on the other. The lifting of his price above a competitive market price will not lose him all his sales. He has an area of choice within which to operate. He has a measure of control over price.

This does not necessarily mean that the producer is a monopolist in the popularly accepted sense of that term, but only that his share of the market is so large in proportion to the whole that he has to take into consideration the effect of his own action on price. A very large proportion of business men are in this condition today. The very fact that business men have a problem of price policy, reflects this area of choice and their partial control of price.

Likewise, an administered price and a monopoly price are quite different aspects of price. According to traditional analysis, there is no reason to expect monopoly price to adjust less frequently to changes in demand than would a competitive price. It would change in a different degree but not less often. The presence of monopoly prices in the economy might result in unfair prices but need not disrupt the functioning of the economy. Inflexible, administered prices—whether in a monopoloy situation or in a more competitive situation—do act to disrupt an economy depending upon price flexibility to bring about economic adjustment—to bring overall co-ordination among its different parts.

There have been frequent proposals to deal with our present situation by breaking up some of the more concentrated industries and placing the remainder under government regulation or government ownership. It is felt that if there are a number of competing companies or if government sets prices, the results will be satisfactory. If the only problem were one of getting fair prices, this solution would be basically sound. Where there are a few truly independent firms competing, prices are likely to be, on the whole, fair to the consumer. Likewise, government regulation or ownership should, over a period, give fair prices. But such a solution does not meet the more basic problem. Inflexible, administered prices would not be eliminated. In the government regulated or owned industries, prices would be administered by the government itself and though they might be fair they would tend to be inflexible, much as railroad and postal rates have been. In the industries dominated by a few big competitors, administered prices would undoubtedly appear and though there might be sufficient competition to make them reasonably fair, they would be likely to be inflexible. Such a solution might thus lead to greater fairness of price but would not produce the overall co-ordination because it not only fails to deal with the problem of overall balance presented by inflexible, administered prices, but to the extent that it increased government regulation or

ownership of particular industries it might tend to aggravate this problem. It might tend to leave the economy in an even worse state than at present so far as overall co-ordination is concerned.

Finally, I want to make it clear that in pointing both to the fact and the importance of inflexible, administered prices, I am not saying that inflexible, administered prices are wrong. They seem to me inherent in modern technology. Nor am I saying that the inflexible prices should have come down during the depression. According to the rules of the laissez faire game, they could not be expected to come down. I am only saying that inflexible, administered prices are incompatible with automatic economic adjustment. Our economy has developed to the point where we simply cannot rely on the actions of individuals or enterprises acting independently to produce overall co-ordination and an effectively functioning economy. Unless we are willing to forego the benefits of modern technology, we are faced with the real task of figuring out how economic co-ordination can be achieved in the presence of inflexible, administered prices.

This is the task which must be a challenge to those economists who seek to be constructive in the present day. How can we obtain sufficient overall co-ordination of economic activity, yet at the same time retain the very real advantages of individual initiative and responsibility? The AAA accomplished an important degree of co-ordinate action among farmers without destroying the advantages of individual farming and the self-reliance of that great individualist, the American farmer. How, for the economy as a whole, can co-ordinate action be induced so as to give sufficient balance to allow full use of improved technology and of human and material resources?

EFFECT OF THE DEPRESSION UPON EARNINGS AND PRICES OF REGULATED AND NONREGULATED INDUSTRIES

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NOTE.—Space limitations prevent the publication of the rather voluminous footnotes to this paper. They may be secured in mimeographed form upon application to the authors. The numbers throughout the paper indicate the location of footnotes. EDITOR.

The assumption is commonly made that the behavior of prices and earnings during a depression is radically different in regulated and nonregulated industries. It is the purpose of this paper to offer approximate measurements of the differences that have recently appeared and by a sampling process to examine the depression records of leading types of regulated and nonregulated industries. It is scarcely necessary to state that we claim no definitive accuracy for our results.

By regulated industries we mean the principal local public utilities, especially electric light and power, telephonic communication, manufactured gas, and railroad transportation. Nonregulated industry will be represented by a selected group of manufacturing enterprises. These terms do not, of course, imply perfectly regulated monopolies on the one hand and perfectly uncontrolled competitive enterprises on the other. Important elements of "control," both governmental and non-governmental, exist in each group, although they assume much greater significance in the utilities.

Primary emphasis will be placed upon the relative changes within each group, and their comparison, rather than upon the absolute level of either earnings or prices. While the data do justify certain conclusions with respect to absolute earnings rates, their measurement is less reliable than that of year-to-year change, requires more qualification, and will not here be emphasized.

The period employed will be 1928-35 inclusive, although in certain instances the period will begin with 1929 and end with 1934. Data for 1935 are estimates.[1]

I. Earnings: Regulated Industry

Local Public Utilities. Debt is so important in the capitalization of both local and national public utilities that two measures of earnings are employed. The first is net operating and non-operating revenues, after depreciation, taxes, and rentals, but before interest. This item will be related to total capitalization, which includes long-term debt and short-term loans and notes (when available), plus capital stock and surplus. Bond discount and reacquired securities, if carried as assets, are subtracted. This ratio of earnings to capital we shall call the "total return."

The second earnings ratio we shall term the "equity return": net income after interest, but before dividends, divided by capital stock and surplus.[2]

Aside from privately owned water supply companies,[3] the electric light and power industry shows the greatest resistance to the forces of depression. A sample of 25 operating companies[4] comprising approximately one-fourth[5] of the privately owned electric light and power industry discloses a total return of 8.2 per cent in 1928 and 8.3 per cent in 1929. The lowest level was reached in 1934 with 5.7 per cent, a decline of 30 per cent from 1928. Estimates for 1935 indicate a slight increase from 5.7 per cent to 5.9 per cent.

The equity return shows a 43 per cent decline, from 10 per cent in 1928 to about 6 per cent in 1934. It is significant that each year the return, after interest, on equity capital is higher than the aggregate return upon total capitalization. As a group, these operating companies earned their interest deductions 2.6 times in their poorest year, 1934, and approximately 3 times in 1932.[6]

The record,[7] both here and in certain of the other local utilities, may tend somewhat to understate rather than overstate the absolute level of earnings because of a tendency to over- rather than undervalue assets in relation to original cost. However, the electric light and power capitalization data have been adjusted to eliminate whatever write-ups were disclosed by information published in *Moody's Manuals*, and in the recent investigations of the Federal Trade Commission. Likewise, at least 11 companies of the 25 in our sample are located in states where control of accounts has for many years operated to minimize write-ups of assets and capitalization.[8]

Consolidated information for the Bell Telephone system, representing over 85 per cent of the entire industry, shows total and equity rates of return almost exactly equal in 1928 and 1929 to those of the electric industry. The total return was 8.1 per cent in 1928 and 8.3 per cent in 1929, while the equity return amounted to 9.4 per cent and 10 per cent in 1928 and 1929, respectively. Telephone earnings declined somewhat more than the electric, however, reaching a low of 4.7 per cent in 1933, in contrast to 5.7 per cent for the latter industry in 1934. An upturn to 5 per cent in 1934 and an estimate of perhaps 5.5 per cent in 1935 is probably due, in part at least, to relatively greater freedom from price reductions during the past several years.

Manufactured gas discloses a somewhat less favorable record than either of the above local utilities. Data published by the American Gas Association[9] for identical companies, 1929-34, show total and equity rates of returns of 7.7 and 8.2 per cent, respectively, in 1929. From that point a rather steady decline occurs through 1934, when the total return was 4.3 per cent and the equity return, 3.3 per cent. The ratio of long-term

debt to capitalization is 42 per cent, only slightly less than that of electric industry.

The financial plight of the electric railway industry, with an accompaniment of failures and abandonments, makes any close estimate of its record impossible. It is far worse than that of any other local utility. Census data for 1927 and 1932 showed a decline in operating income from $174,422,044 to $83,013,495. The American Transit Association estimated[10] the same item to be $85,160,000 for 1933 and $88,080,000 in 1934. These data, of course, are affected by abandonments of electric railway in favor of bus operations. The capitalization for electric railways only was given by the 1932 Census as $4,267,505,955.[11] Upon this the operating income for 1932 affords a return of approximately 2 per cent. The Census reports a deficit after interest of $9,456,534.

Railroads. Estimating the return on capitalization for steam railroads is extremely difficult because of a "flexible" depreciation and maintenance policy. Ostensibly, the total return for Class I carriers,[12] including non-operating income, was 5.5 per cent in 1928 and 5.8 per cent in 1929. It then declined in successive years to a low of 1.65 per cent in 1932. In 1933 and 1934 it stood at 2.2 per cent and 2.1 per cent, respectively. The equity return declined from 6.8 per cent in 1929 to deficits of 1.1 per cent in 1932, .05 per cent in 1933 and .14 per cent in 1934. Earnings for 1935 will probably somewhat exceed those of 1934.[13]

Deferring of maintenance and charging of retirements and repairs directly to surplus rather than to operating expenses, however, make the above percentages an overstatement. To what extent has maintenance been deferred? According to the Interstate Commerce Commission, "it appears that the maintenance work in . . . [1933] could justifiably have been stepped up over 25 per cent without considering the accrued deferred maintenance, amounting to possibly half a billion dollars for a volume of traffic reasonably in prospect."[14]

If we apply this 25 per cent estimate to the 1933 maintenance expenditures, we obtain $230,248,831 of deferred maintenance. Subtracted from net before interest, the result is a total return of 1.2 per cent instead of 2.2 per cent. After similar adjustment, the equity return is changed from a deficit of .05 to a deficit of 1.9 per cent.

The immediately beneficial results that might have been expected to follow from the upturn in railroad traffic in 1933, 1934, and 1935 have been largely offset by rising costs of materials and by increasing expenditures for maintenance in 1934 and 1935, coupled with cumulative restoration in railway wages from July, 1934, through 1935.

II. Earnings: Nonregulated Industry

The earnings record of nonregulated manufacturing industry affords an interesting contrast to that of the regulated groups. A sample of 47

corporations enables us to observe the experience of the larger manufacturing companies from 1928 through 1935.

The 47 corporations included in the sample possessed, in 1931, about 8 billion dollars of equity capital, or roughly one-sixth of that in all manufacturing, large and small, and nearly three-fifths that possessed by all manufacturing companies with assets of over $10,000,000 each.[15]

In 1928, these 47 companies earned 10.7 per cent on stockholders' equity.[15a] In 1929, the equity return reached a peak of 13.2 per cent. Then began the decline. It was 7.9 in 1930, 3.2 in 1931, and there was a negative equity return of .1 per cent in 1932. The total return in 1932 was positive, but only slightly so—.3 per cent.

Recovery showed its effect in 1933, when the equity rate was about 3 per cent. The 1934 figure further improved to nearly 4 per cent (3.9) and the preliminary return for 1935 is 5.5 per cent—a marked contrast to aggregate returns of about zero in 1932 and about 3 per cent in 1933.

Another measure of financial improvement in these 47 companies is found in the number with deficits. In 1928, 3 were in the red; in 1929, only 1. But in 1932, no less than 21, or nearly 50 per cent of all the companies, recorded net losses. In both 1934 and 1935, however, this number was cut to 9, or about 20 per cent of the total number.

We are not able to divide this sample of manufacturing companies into a great number of different industries, because too few companies would appear in each to possess any general significance. We may, however, break down the figures by five broad industrial groups as follows: foods; textiles; metal products, including automobiles; chemicals, including petroleum; and miscellaneous manufacturing. The latter was included chiefly to round out the combined figures for the sample; i.e., so that the capitalization of the sample would have about the same relative industrial composition as do the complete figures for large-scale manufacturing industry as a whole.

Thus broken down by groups, we find by far the greatest stability in food products, where annual returns ranged between about 12 to 9 per cent during the years 1928-32. The 1933 return was 7 per cent, but 1934 and 1935 are back between 8 and 9 per cent.

In metal products, on the other hand, earnings of about 14 per cent in 1929 evaporated to a net loss of about 3 per cent in 1932. The 1935 rate is over 4 per cent. But it would not be anything like that figure if automobiles were not included. Nor would the 1935 rate of return for all our manufacturing companies be so high as 5.5 per cent if automotive companies' profits were eliminated. For the motor manufacturing companies, by having had an exceptionally good year because of a large replacement

[15a] In general, only the equity returns will be presented as, in the manufacturing field, the total return in most years is not very different because of the small average proportion of funded debt.

demand, and also through having inaugurated the autumn season as the time for introduction of new models, have seen a sharp increase in current year profits. The 4 motor companies included in this sample (after an aggregate deficit in 1932) earned 6 per cent in 1934 and now show 10 per cent in 1935. Their estimated net income in 1935 amounts to nearly 40 per cent of the aggregate net income of all our 47 companies although their capital is only one-fifth as large. Take these motor companies out, and the 1935 equity return in the metals group shrinks from 4.3 to only 1 per cent.

For all manufacturing, the difference, of course, is not so great, but it is still substantial; the 5.5 return including automobile companies becomes 4.3 per cent without them. Whether the automobile industry will again prove so profitable relative to the other groups in 1936 remains to be seen. But it is clear than one artificial, albeit desirable, factor which has helped the motor industry this year will not help it next. Changing the date of models, which brought about two great seasonal peaks within the same twelve months, produced income which, as the accountants say, is a non-recurring credit.

III. Prices: Regulated Industry

The measurement of prices in certain of the public utility and railroad groups confronts three grave obstacles. One lies in the complicated price structures which characterize most of these businesses. In certain instances, notably in the electric field, average unit price is seriously influenced by a so-called "promotional rate structure," where price varies with the quantity used.[16] Then, too, both rate levels and rate structures vary greatly in different parts of the country. A third diffculty lies in the differentiation of customer groups and the quoting of different rates to such groups in accordance with variations both in "what the traffic will bear" and in cost of service. This is especially true of railroads, electric, telephone, and, to a certain extent, of gas rates. Consequently, the "measurements" which follow are, in certain cases, scarcely to be dignified by the application of so statistically complimentary a term.

The price record of utilities readily divides into three parts. In one we find instances of almost complete price stability; in a second, extreme instability approximating that of some unregulated groups; in a third, a price behavior somewhere between these two extremes.

Stable Utility Prices. Almost complete price stability characterizes the record of the street railway, telephone, and manufactured gas industry (in its domestic sales). Of two comprehensive indexes of street railway fares, one shows a rise of about 4 per cent between 1929 and 1935,[17] and the other, virtually no change.[18]

Domestic sales (excluding house heating) of the manufactured gas in-

dustry provided 67 per cent of its 1934 revenue. The Department of Labor Index of the price of 3000 cubic feet per month, for selected cities (1913 = 100) was 127 in 1928, 128 in 1929, and 121 in 1932. In 1934 this index stood at 120, or a decline of over 6 per cent from 1929.[19] Average revenue per unit of sales, on the other hand, for the country as a whole showed almost no change.[20]

Telephone rates have changed very little during the past five years.[21]

Unstable Utility Prices. Turning to instances of comparatively drastic price reductions, we have steam railroad passenger rates, which declined almost one-third during the period 1929-35. While the base rate of 3.6 cents per mile remains unchanged in eastern territory, so many special fares have been quoted that rates in fact have fallen greatly. A fairly reliable guide is afforded by taking the average revenue per passenger mile, excluding commutation traffic.[22] Using 1929 as a base, revenue per passenger mile for non-commutation traffic declined to a low of 66 in 1934. The index for all passengers including commutation was 68 in 1934.[23]

Moderate Price Declines. Railroad freight rates, the price of electricity, and of manufactured gas for industrial and commercial purposes, have declined very moderately. In each case the decrease probably has not exceeded, and in some cases undoubtedly has even been less than, 10 per cent.

From a revenue standpoint the electric market is fairly evenly divided between domestic service, small or retail commercial light and power, and large or wholesale light and power supplied to industry.[24] As a result of granting lower rates on larger blocks of power,[25] average revenue per kilowatt hour sold to large industrial users is an entirely unreliable index of rates if taken alone, due to the fact that a decline in volume during the depression operated to raise the average kilowatt hour price. Consequently, the average revenue per kilowatt rises from 1929 to 1932, with declining consumption, and falls from 1932 to 1934, with a rising use.[26]

A better indication of the decline in large power rates, although still highly imperfect, is afforded by a comparison of average per kilowatt hour rates in years when aggregate consumption was substantially equal. In 1934, total large power consumption was slightly less than in 1931. This, of itself, would tend to produce a higher price in 1934 than in 1931. We find, instead, a decline of about 10 per cent. Consumption in 1931, however, was almost exactly equal to that of 1928 and the average price was virtually constant between the two years,[27] thus suggesting little change in the rate or price level between 1928 and 1931. This evidence, fragmentary though it is, would suggest that electric power rates have declined somewhat, probably between 8 and 12 per cent.

Agitation for rate reductions has centered chiefly on residential household rates. Here again, evidence does not make possible a definitive meas-

urement of rate changes. One conclusion, however, can be reached with certainty. While in some cities rates have not been reduced at all, in a few places the reduction has been drastic. The latest information published by the United States Department of Labor,[28] for example, shows reductions of as much as 38 per cent for large blocks[29] of residential electricity, between July 15 and October 15, 1935, in certain boroughs of New York City.

Residential electric rates, for the country as a whole, probably have declined between 5 and 10 per cent. Commercial or retail power rates have decreased by a smaller amount, probably between 4 and 6 per cent. It seems quite certain that residential rates in the aggregate have been reduced by less than 7 per cent in the period 1932-35 inclusive.[30]

The only commonly used index of railroad freight rates is average revenue per ton-mile. With 1929 as a base year this index declined to a low of 91 in 1934 or a reduction of 9 per cent.[31] Two factors impair the accuracy of this index, however. One is the change in length of haul, which during recent years has operated to reduce the average revenue per ton-mile.[32] In the years following 1929 this tendency resulted from the increasing loss of short-haul traffic to motor transportation.[33]

A second difficulty results from shifts in the relative proportions of high and low revenue freight. A lower revenue per ton-mile may result merely from the fact that relatively more low revenue freight is being carried. Sufficiently refined data are not available to test this point quantitatively. Initial computations, however, suggest that this factor may have had considerable effect upon the average revenue per ton-mile.[34]

There have been, of course, countless reductions in particular rates to meet the competition of motor and waterway transportation. On the other hand, the Commission has permitted two emergency increases in rates—one taking effect in 1932 and continuing until September 30, 1933[35]; the second taking effect in the second quarter of 1935 and continuing until June 30, 1936.[36] In a 1933 decision, the Commission refused to order a reduction in rates.[37]

While the rate level probably has fallen somewhat, at least in 1934 when the initial emergency increases had expired, the extent of the decline is problematic. Probably it has been substantially less than that suggested by the 9 per cent reduction in the average revenue per ton-mile.

IV. Prices: Nonregulated Industry

In analyzing the price movements of commodities produced by our five manufacturing groups, we have taken the Bureau of Labor Statistics' annual indexes of wholesale prices for industries which in general correspond to our grouping. These have been given weights equal to the proportionate amounts of capital possessed by the several groups of our sample in the

year 1931. To take such individual industry indexes, each of which rests upon several price quotations already averaged, and then to combine them through further weighting may not represent a mathematically impeccable procedure, but, it is the only method available under the circumstances and for comparative purposes will serve better to show broad movements than would the unweighted figures.[38]

In this index, automobiles are omitted, since no adequate price index for them is available. Thus in speaking of "all groups" or "all manufacture" in this section, and also in making comparisons of price and profit movements in a later section, it should be understood that while metal products such as railroad cars, electrical equipment, machinery, machine tools, and castings and forgings, etc., are still included, automobiles are not.

Such an index of wholesale commodity prices for the five manufacturing groups, with 1928 as a base year, remained at about 100 in 1929, and then fell to about 91 in 1930. This was a 9 per cent decline. But the 1930 absolute amount of net income for these manufacturing industries fell by 41 per cent and the rate of return by 40 per cent, from 1929 levels. Price declines, of course, were only one element in the shrinkage of profits; loss of sales volume and consequent increases in overhead costs per unit were associated and equally important factors.

During 1931, 1932, and 1933, the combined price index for the manufacturing industries in our sample stood at 78, 74, and 73 respectively. But the return on equity capital fluctuated far more. It was about 3 per cent in 1931, a deficit in 1932, and nearly 3 per cent again in 1933.

Between 1933 and 1935, the price index rose about 9 points; that is, from 72.7 to 83.0, the latter figure being based on averages for the first nine months of the year. This is a 14 per cent increase, while the rate of return on capital between 1933 and 1935 approximately doubled.

Finally, we may observe that between 1934 and 1935, the price index increased scarcely at all—from about 81 to 83.

V. Summary

What do the records of the several industries we have reviewed show when summarized and compared?

In general, we observe these things:

1. The earnings of most industrial groups reached their depression lows in 1932, while those of most utilities did not do so until 1934.

2. A similar lag occurred in price movements. The industrial prices reached bottom in 1932 and 1933 (the combined index was fractionally lower in 1933). But utility prices reached their lows in 1934 and in some cases are still undergoing declines.

3. Wherever drastic declines have occurred in regulated prices (e.g., railroad passenger traffic) the cause has been essentially economic rather

than regulatory. In the harassed transport industries, the effect of regulation has been to authorize certain price increases, while in certain other utility fields it has resulted in price declines after other commodity prices had reached bottom. This is well illustrated in the electric light and power industry.

4. Industrial earnings, in the aggregate, fell from high levels in 1928-1929 to zero in 1932. But this is not true of one broad industrial group: from peak to trough, the earnings of food products companies declined by less than one-half and at the low point stood at about 7 per cent; furthermore, this low point came in 1933 instead of 1932 as with other industrials.

In the regulated fields, no total return declined to zero, although equity returns did so in transportation. In electric companies, on the other hand, the total return declined only by a third and the equity return by a half, while only slightly less favorable results obtained in the gas and telephone groups.

5. No non-transport utility failed to earn its fixed charges with a wide margin of safety, despite the relatively high debt ratios that characterize their capital structures.

6. As for prices, comparative stability characterized some utilities; namely, telephone, street railway, and gas manufactured for domestic purposes; great instability characterized railroad passenger fares, which dropped by about one-third; midway between these other fields are found electric rates and railroad freight rates, which declined probably by less than 10 per cent. Prices in the industrial (nonregulated) fields, however, fell on an average by nearly 30 per cent.[89]

All this suggests that for both industrial and public utility groups during the downswing of the cycle, the causes of declines in either prices or profits are economic rather than regulatory. An exception to this might be required if it could be demonstrated that certain utilities, e.g., street railways, would have profited from decreased prices. Even under such circumstances, regulation assumed a negative rather than a positive responsibilty. It did not attempt to force price reductions on the theory that such reductions would stimulate sales sufficiently to produce larger net profits. During recovery, however, regulation is positively responsible for utility prices not increasing, and to a lesser extent, for the failure of utility profits to rise appreciably.

An examination of the behavior of both prices and profits within each group suggests that the primary economic forces at work relate to differences in costs and in markets. A principal market difference between the railroads and other utilities is that demand for the product is in substantial measure a consumer demand in the non-transport field, while in transport

the demand is principally a derivative of general business activity. Much the same distinction prevails between the food products and other manufacturing groups. Space permits no discussion of demand elasticity, differences in the proportion of non-capital costs of production, differences in the secular characteristics of the several industries, variations in stability of demand in the schedule sense, and the degree and character of competition present in each case. These remarks require more elaboration and justify further analysis than can here be essayed; we hope later in another place to extend them.

Furthermore, nothing concerning the degree of causation or even the correlation existing between prices and profits has been assumed or implied in our recital of the facts for the eight-year period under discussion. The data in themselves do not tell us much in this respect. They do indicate the presence of correlations, some of which are inverse.

How much price increases during 1933-34 contributed to the gain in industrial profits it is difficult to say. Undoubtedly, they aided in manufacturing products or on portions of railroad freight where demand was either inelastic or, in a schedule sense, increased rapidly and induced a larger volume of business operations. During the last year, that is, between 1934 and 1935, it seems clear, however, that the gain in profits has not been achieved primarily or even largely as the result of price influences.

Reverting to years of sharp price recession, however, declining prices and markedly lower profit rates are, of course, closely associated when sales volume recedes concurrently. As a general statement, this in itself is so obvious as scarcely to be worth mentioning. On the other hand, we are unable to state the character and importance of the price decline in comparison and in conjunction with other influences. At all events, the industrial groups of our manufacturing sample in which prices fell most, between 1928 and 1932, are not those in which profits rates declined most. The metals groups suffered a deficit in 1932, and its price index stood at about 83. But in the food group, which earned 9 per cent return, the price index was down to 60. This is not, however, proof that high correlation between prices and profits, in different industries during the downward trend, is absent; again our groups are too few, and their industrial classification too broad, to enable generalization in this respect.

All we can say is that a recovery in profits, once started, can seemingly gain momentum, in its secondary stages at least, without being accompanied by any appreciable and continuing rise in the price of commodities. Certainly between 1934 and 1935, expanding business volume, rather than ascending prices, has been the primary cause of increased profits in both regulated and nonregulated fields.

SIZE OF PLANTS IN ITS RELATION TO PRICE CONTROL AND PRICE FLEXIBILITY

By SPURGEON BELL
Federal Home Loan Bank Board

Dr. Means has presented the facts in regard to price flexibility in a fairly elaborate analysis without reference to particular commodities. My interest in the problem will be remembered by those who may have seen my analysis on fixed costs in relation to market price which appeared in the *Quarterly Journal of Economics* of May, 1918. I am interested in the relation between the facts and a theory as to the cause of price flexibility and price rigidity. The chief factors bearing on this problem to which I referred in my earlier analysis were the overhead factor and the style and quality factor as it applies to particular commodities.

Investment in Fixed Assets in Its Bearing on Price Flexibility. For orientation purposes it may not be amiss to repeat some of the things that may have been said before on the effect on competitive price of the investment in fixed assets. In arriving at a correct statement of the operations of competitive enterprise it must be recognized that the chief purpose of the managers is to earn profits or a return on invested capital. As long as the invested capital is predominantly working capital it is not generally profitable to sell below cost and dissipate this captial. But as the invested capital becomes predominantly fixed assets such as plant and machinery, it may be advisable in a period of overcapacitation to sell in a competitive market at a price which slightly more than covers the additional cost of getting additional business, thus reducing the loss which would otherwise be incurred. This is an application of railroad rate theory involving parallel lines to overcapacitation in manufacturing enterprise with a large overhead in the way of fixed investment.

Maintenance of a Minimum Organization. In this matter of fixed overhead the question of a minimum organization for expansion in a later period of less overcapacitation is also involved. So far as the present business volume is concerned The American Telephone and Telegraph and the large tire and rubber plants might tend to reduce heavily their research staffs and their technicians in various lines, but these organizations must think in longer terms and maintain a minimum staff of technicians and skilled workmen so that they will be in a flexible position when times are better. All of these matters have been stated and do not need further amplification in this connection.

Technical Developments During the Past Generation. During the past thirty years there has been a rapid development in industrial technique involving an increasing investment in machinery as compared with the number of wage earners employed. Table No. I shows that the horsepower

TABLE I

HORSEPOWER PER WAGE EARNER IN MANUFACTURING INDUSTRIES, 1899–1929

Year	*Horsepower per Wage Earner*
1899	2.11
1904	2.48
1909	2.87
1914	3.23
1919	3.26
1923	3.77
1925	4.27
1927	4.65
1929	4.86

per wage earner has more than doubled during this period. In 1899 the number of horsepower per wage earner in manufacturing in the United States was 2.11, while in 1929 it was 4.86, an increase of 130 per cent. While this may not be an accurate measure of the extent of the increase in mechanization during these years, it is indicative of what has been happening in mechanization and increasing investment per wage earner employed.

Before 1899 the era of free competition in the iron and steel industry was already breaking down in an effort to substitute some type of regulated competition for the purpose of preserving the value of invested capital. Similar developments took place in other countries for similar reasons. That these tendencies were forced by the technical processes and market situation involved may be inferred by their wide prevalence in the leading industrial nations. While these tendencies may have some unfortunate consequences, none of the industrial nations have discovered how to avoid them.

The Factor of Size of Plant. But what has this development to do with the size of plants and why has there been such variety in the degree of price stabilization in various industries? While no full and decisive answer may be given to this question it is possible to make some observations which are suggestive of the causes that are operative in the current situation. While price competition is severe in some machine industries the efforts to bring about a stabilization of price seem to fail with a resulting continuous depression in these industries. If the advantage of plant size in any industry is such that the major part of the total product tends to be produced by a few large concerns, the possibility of developing large companies with some system of price competition is greatly enhanced. Now there are some data in the census volumes which have a bearing on the explanation of the causes of concentration and price control. Some examples may be cited as having some value as evidence.

Industries in Which There Is an Advantage in Size. On this advantage in size let us take the steel works and rolling mills. Table II and Chart I shows the computation value of product per wage earner for differing

TABLE II
VALUE OF PRODUCT PER WAGE EARNER, BY SIZE OF ESTABLISHMENT, SELECTED MANUFACTURING INDUSTRIES—1929

Size of Establishment by Value of Products (thousands of dollars)	Value of Products per Wage Earner					
	All Industries		Steel Works and Rolling Mills		Tin Cans, Etc.*	
	Dollars	Index Numbers Industry Avg. = 100	Dollars	Index Numbers Industry Avg. = 100	Dollars	Index Numbers Industry Avg. = 100
All Establishments	7,969	76	8,530	95	9,426	71
5 and under 100	4,865	46	3,990	45	5,055	43
100 and under 500	5,992	57	4,177	47	5,820	50
500 and under 2500	6,848	65	5,111	57	7,692	66
2500 and over	10,551	100	8,941	100	11,627	100
Per cent of total products manufactured in largest plants§		53		94		61
	Cotton Goods		Tools, Implements†		Leather Tanned, Curried and Finished	
All Establishments	3,587	97	5,152	95	9,640	96
5 and under 100	3,479	94	4,700	86	4,155	42
100 and under 500	3,447	93	5,302	98	7,140	71
500 and under 2500	3,503	95	5,118	94	10,180	102
2500 and over	3,699	100	5,436	100	10,007	100
Per cent of total products manufactured in largest plants§		47		12		49
	Boots and Shoes		Soap		Rubber Tires and Inner Tubes	
All Establishments	4,697	89	21,597	94	9,250	99
5 and under 100	3,315	63	11,183	49	‡	‡
100 and under 500	4,077	77	17,785	77	6,371	68
500 and under 2500	4,517	85	17,255	75	7,592	81
2500 and over	5,291	100	23,017	100	9,347	100
Per cent of total products manufactured in largest plants§		40		81		96

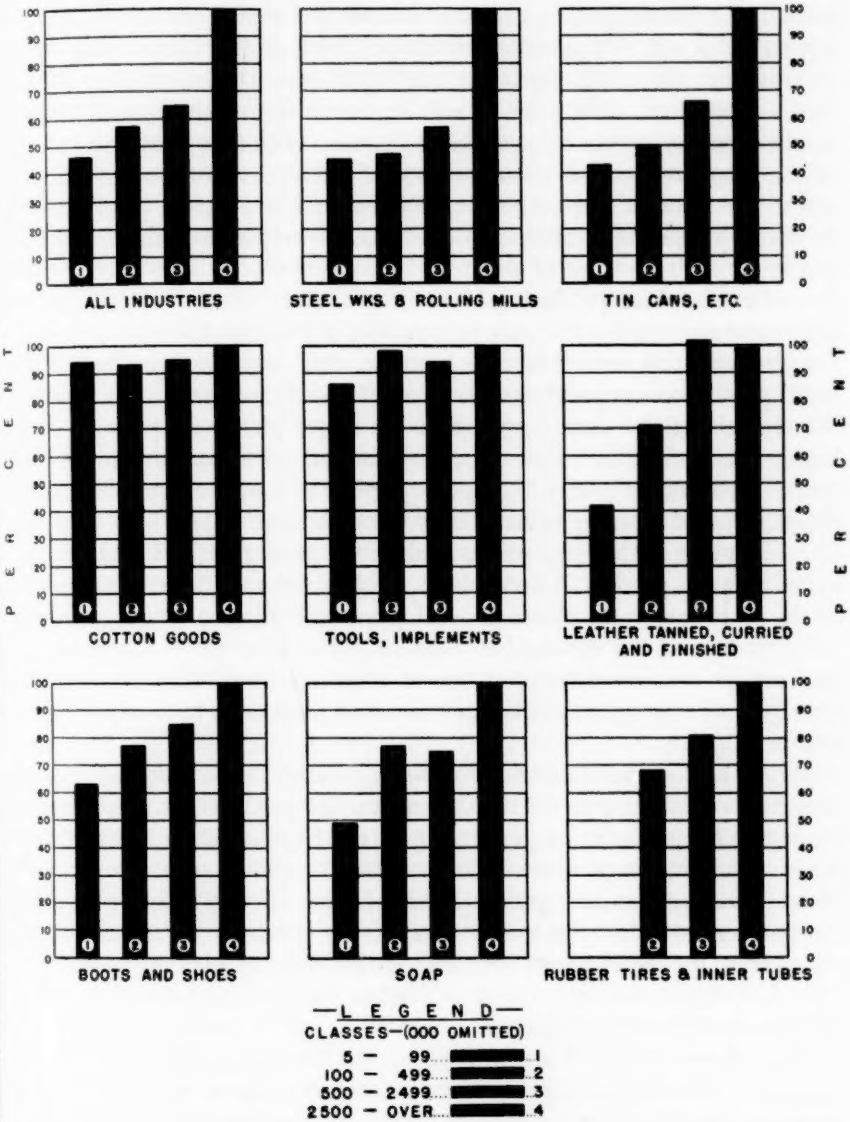
* Tin cans and other tinware not elsewhere classified.
† Tools, not including edge tools, machine tools, files, or saws.
‡ Omitted because plants in this group employ less than 100 wage earners.
§ Plants with value of products $2,500,000 or over.

size of plants in the industry. The table shows that any plant with less than $2,500,000 of annual product seems to operate at a distinct disadvantage. For example, a plant with $500,000 to $1,000,000 of annual product produced in 1929 a product of $4,959 per employee, while a plant with $2,500,000 or more in value of output produced a product of $9,219 per employee.

Chart I

VALUE OF PRODUCT PER WAGE EARNER BY SIZE OF ESTABLISHMENT FOR SELECTED MANUFACTURING INDUSTRIES IN 1929

SHOWN AS A PER CENT OF THE VALUE OF PRODUCTS PER WAGE EARNER IN ESTABLISHMENTS WITH A PRODUCTION VALUE OF OVER $2,500,000



Under such circumstances the large plants tend to produce the greater part of the product with a resulting competition of the giants which is destructive competition under a system of unregulated competition. It is so destructive that these few plants, especially when they are producing a staple product like rolled steel, tend to develop large companies that will bring these plants under a common control and reduce the competition to a system that will mitigate the destructive effects of free competition.

This situation which applies to steel applies in a more striking fashion in the production of tin cans, as will be shown from Table II and Chart I. A plant producing tin cans works at greatest advantage provided the size of the plant involves an annual output of $2,500,000 or more of product where the value of the output per wage earner is $10,358 per employee. In plants producing $250,000 to $500,000 of output the value of product per employee has a value of about $4,500 or less than half that in the larger plant. Even in plants producing $1,000,000 to $2,500,000 of annual product the output per employee is only $5,600. While I do not know enough about the production of cans to be able to say to what extent the products of the small plants are comparable with those of the large plants, it is nevertheless true that these data suggest that the larger plants are probably more highly mechanized and that there is a unusual advantage in size. It is of course well known that a high percentage, much over 50 per cent of the product, in the canning industry is produced by one or two large concerns. The advantage of the large plants leads to the production of a high percentage of the total product in these plants and hence the resulting small number of the more important plants producing a staple product create destructive competition and the destructive competition leads to the concentration of production in a few companies, which create the possibility of mitigating the rigors of the destructive competition and result in a tendency to stabilization in prices.

In the all-industry tabulation shown in Table II the same situation is shown. As you get above $100,000 of annual product per plant there is an increasing productivity per employee, the highest productivity per employee appearing in plants with more than $2,500,000 of annual product. This again suggests the greater mechanization of the larger plants and the further fact that the major part of the products of manufacturing comes from the larger plants (See *Fifteenth Census of Manufactures,* 1929, Vol. I, General Report) suggests further the tendency toward the advantage of large-scale production.

Industries in Which There Is a High Mechanization without Large Advantage in Size. It has already been pointed out, however, that there are industries highly mechanized in which the major part of the product does not come from a small number of large plants. Let us take, for example, the cotton goods industry. The value of product per employee does not

increase systematically with the increasing size of plants and, moreover, the value of product per employee in plants producing $2,500,000 or more of annual product is only slightly larger than that in plants of medium size producing an annual product of $500,000 to $1,000,000. (See Table II and Chart I.) Consequently, neither in the spinning nor weaving industries does the major part of the product come from the largest size plants. Consequently, there are so many important plants that they are unable to develop controlling companies that stabilize prices and develop an effective system of price regulation. These facts, together with the fact that the industry is a rather highly mechanized industry with overcapacity, lead to fierce competition, and systematic depression. There is, of course, a high degree of price flexibility together with a rather low scale of wages. The competition is fiercest in those lines producing a comparatively staple product. The production of specialties is well known in the industry as a means of escaping the fierce competition to which staple items are subjected.

Industries in Which There Is Advantage in Size with Concentration without a High Degree of Price Control. If the tire and tube industry be examined, it will be found that there is a large advantage in size with a resulting reduction in the number of competing plants as the total volume of the industry's output increased. (See Table II and Chart I.) There was, consequently, a development of concentration of control in the hands of a very few companies, but there never has developed an effective system of price regulation. If the output could have been reduced to a product as staple as steel billets a system of price regulation would have become almost imperative, but national advertising with changing styles and qualities of output along with the sale to a large body of consumers who can be committed to one or other of the products on a quality basis by advertising campaigns has made it possible to operate with little or no effective price regulations. But even so, the approach to a staple product by the larger companies tends to lead to considerable price difficulty and a rather high degree of price flexibility. When these large companies sell for original equipment, they sell largely on a dumping basis and at a price which would put them into receivership if all the products were sold on this basis. A product not entirely staple can be sold profitably to a large number of unsophisticated buyers, who rely mainly on advertised brands, without a great deal of price regulation by the industry as a whole.

The soap industry is somewhat similar in its competitive aspects to the tire and tube industry. There is a large advantage in size (Table II), but the differing qualities give the industry a slight escape from destructive competition that would result from an entirely staple product.

In the tool and implement industry (not including machine tools, files, and saws) there is apparently no great advantage in size. (See Table II.) The annual value of the product per employee in the small plants is nearly

as large as that in the large plants. Moreover, price control in the industry is not so imperative as in an industry where there is a more staple product or few specialties in the competitive field. However, the existence of many specialties tends to protect the industry from such violent price fluctuations as would appear if more of the products approached the character of staples. On the other hand, if all the plants produced the same product, the whole chain of sequences as to size and concentration in control would be greatly affected by those circumstances.

In the boot and shoe industry there is a considerable advantage in size, with over 50 per cent of the product produced by the largest plants. The products are somewhat like tires and tubes. There is some escape from the rigors of competition through the style and quality avenue, but still there is a sufficient approach to a staple product to yield a fair degree of price flexibility. This flexibility is less than that in the production of leather for two reasons. There is a higher degree of concentration in the industry and the product is less staple in character. (See Table II and Chart I on boot and shoe prices.)

Summary Statement of This Theory of Concentration. This theory of concentration in its relation to advantage of size and type of commodity marketed may be summarized as follows:

a. Mechanization tends to increase the fixed investment overhead, which tends to increase the rigors of competition in an overcapacitated industry.
b. If the buyers are relatively few, well financed, and sophisticated, the competition becomes the more destructive.
c. If there is a large cost advantage in size, the weaker industries tend to disappear and large plants tend to produce the bulk of the product with a resulting concentration of control.
d. This concentration of control results in a price system of some type intended to stabilize prices and preserve the value of investments by making production profitable in the case of the large industries producing a staple product.
e. If the industry can produce a commodity of the specialty type or create a demand through quality advertising, the price competition is less severe. Concentration and some measure of control may develop in such an industry if there is a striking advantage in size.

The Validity of the Conclusions. The statistical data presented in verification of the conclusions are subject to some question. The various plants in a given industry do not produce identical products. The comparison of the value productivity per wage earner in the large plants with that in the small plants may be of doubtful validity. However, the use of the value of product per employee in various industries as a criterion of advantage in size tends to give a satisfactory explanation of a wide range of

CHART II

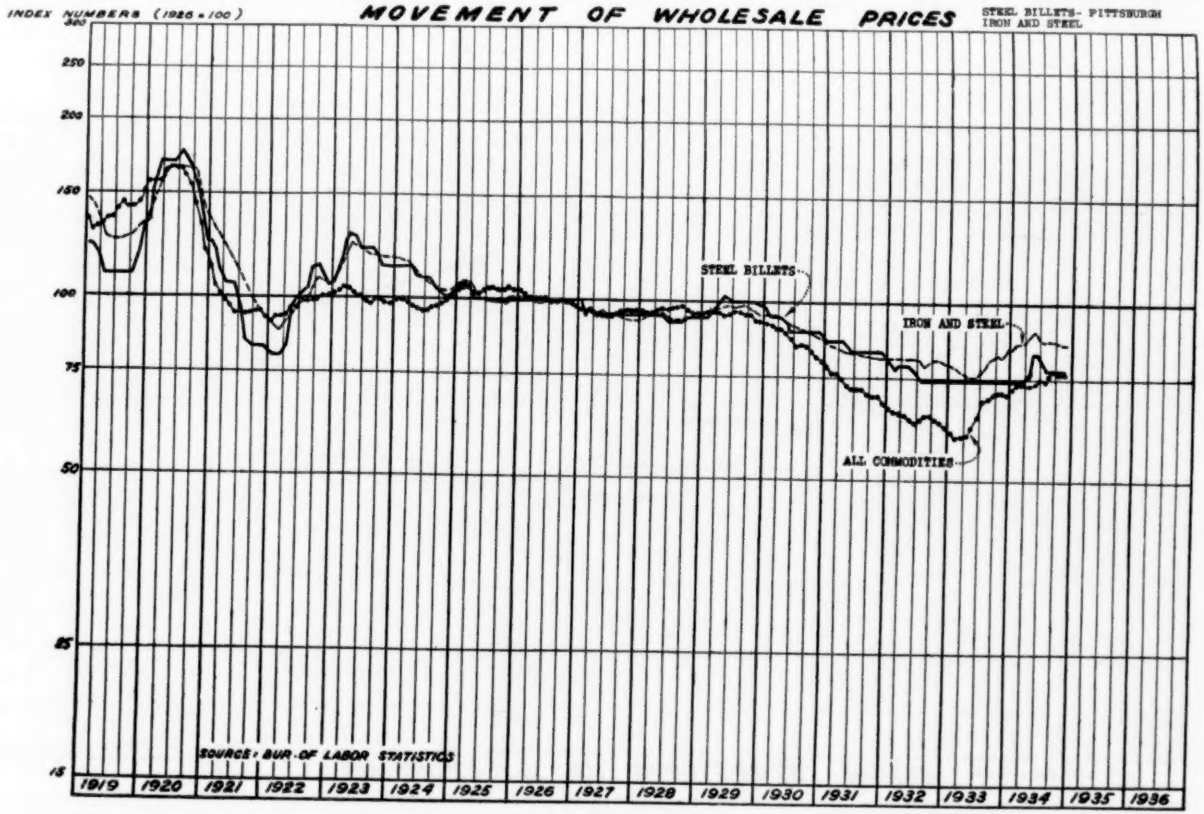

INDEX NUMBERS (1926 = 100)
MOVEMENT OF WHOLESALE PRICES
STEEL BILLETS- PITTSBURGH
IRON AND STEEL
300
250
200
150
100
75
50
25
15
STEEL BILLETS
IRON AND STEEL
ALL COMMODITIES
SOURCE: BUR. OF LABOR STATISTICS
1919
1920
1921
1922
1923
1924
1925
1926
1927
1928
1929
1930
1931
1932
1933
1934
1935
1936

Chart III

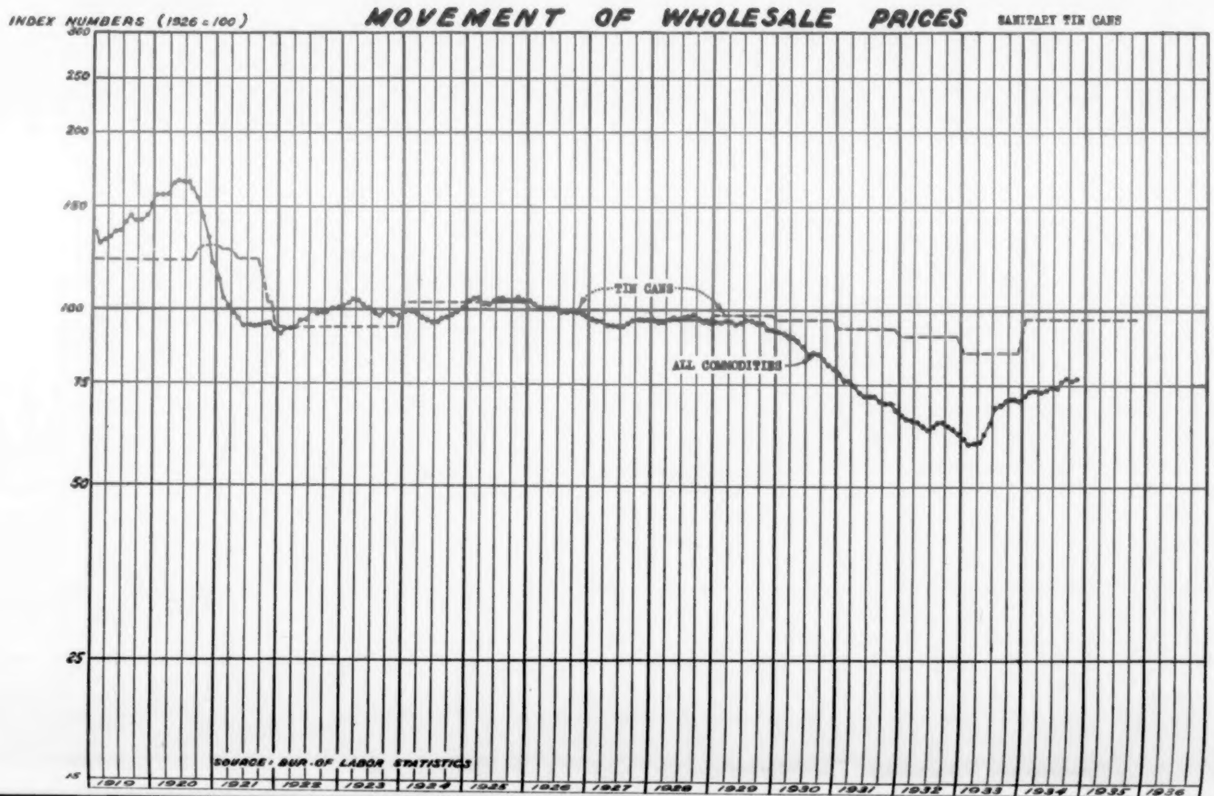
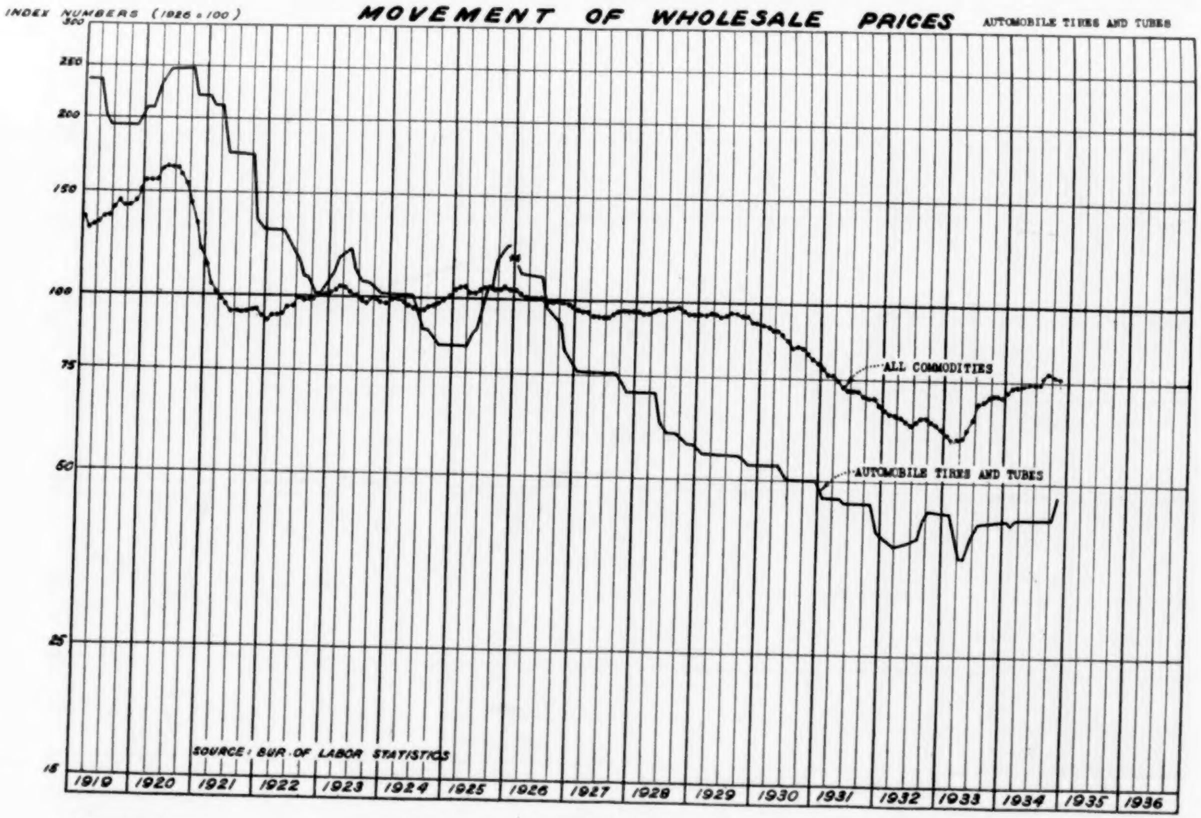


Chart IV

CHART IV



* CHANGE IN SERIES

CHART V

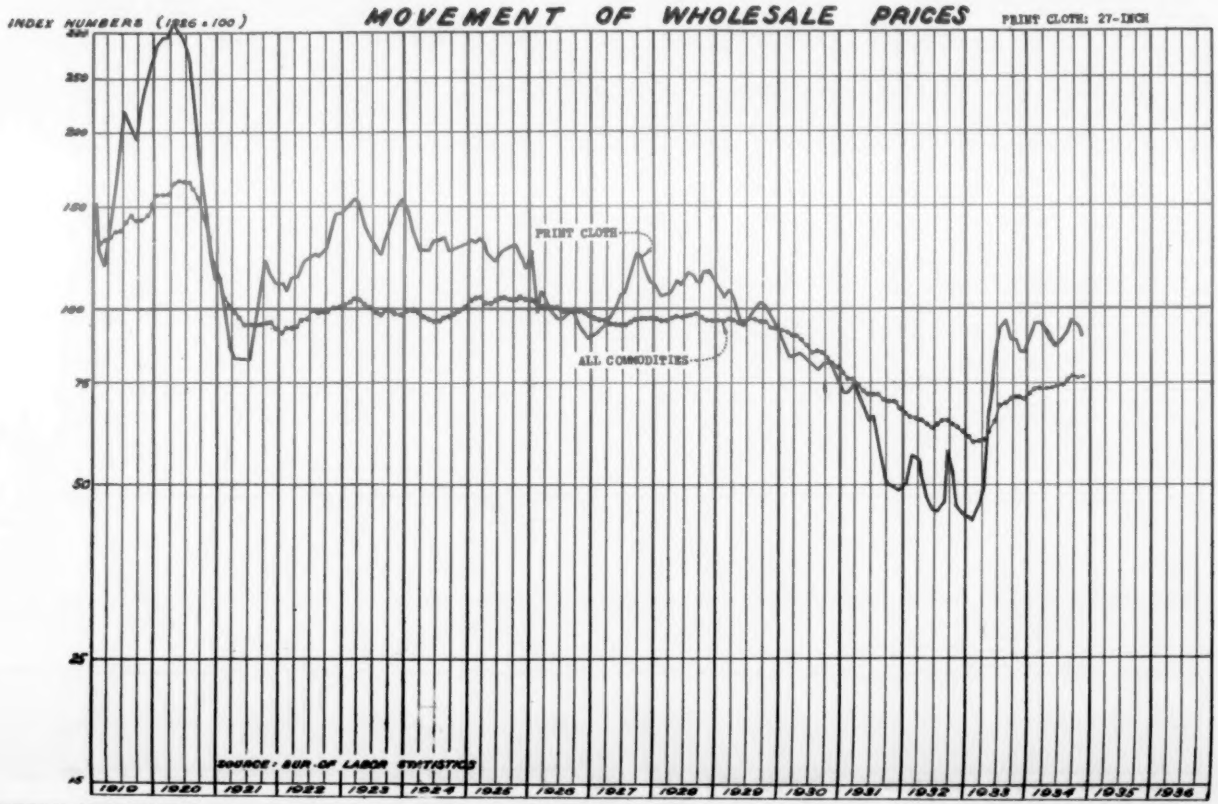


CHART VI

CHART VI

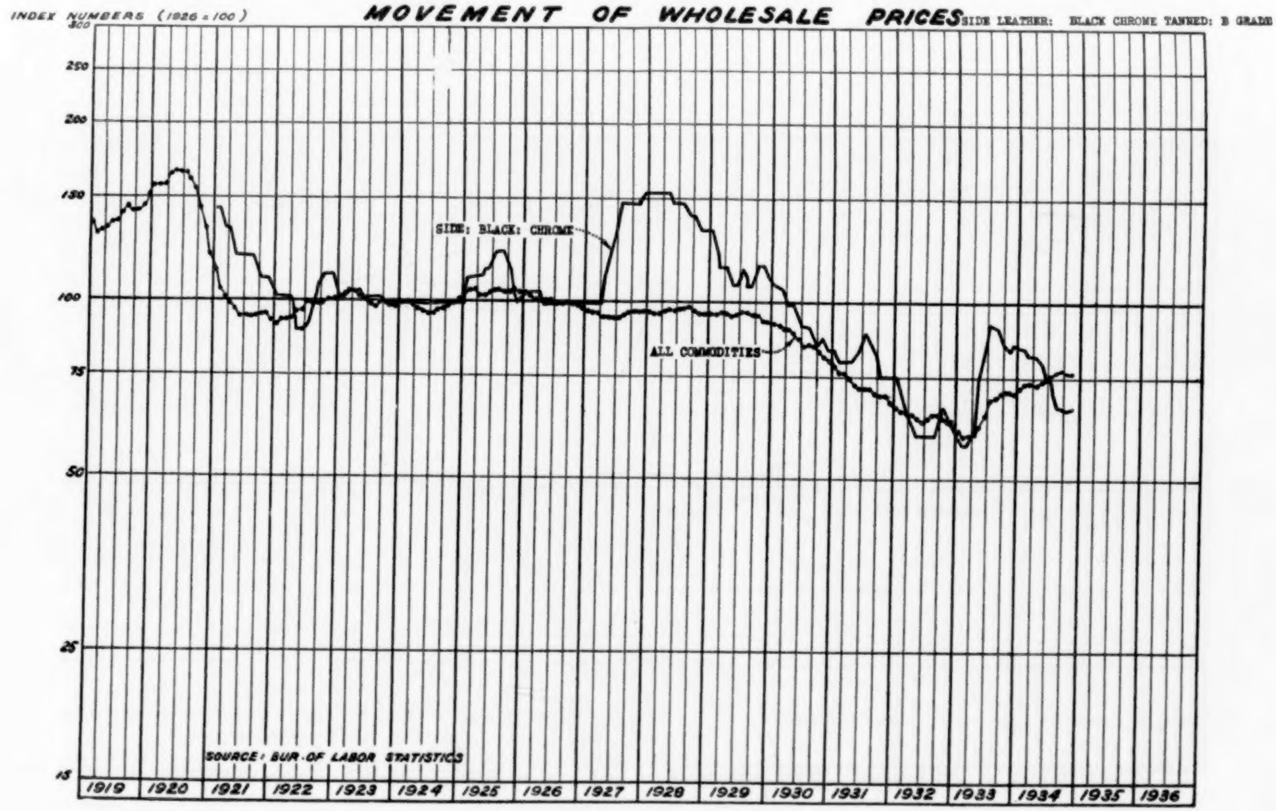
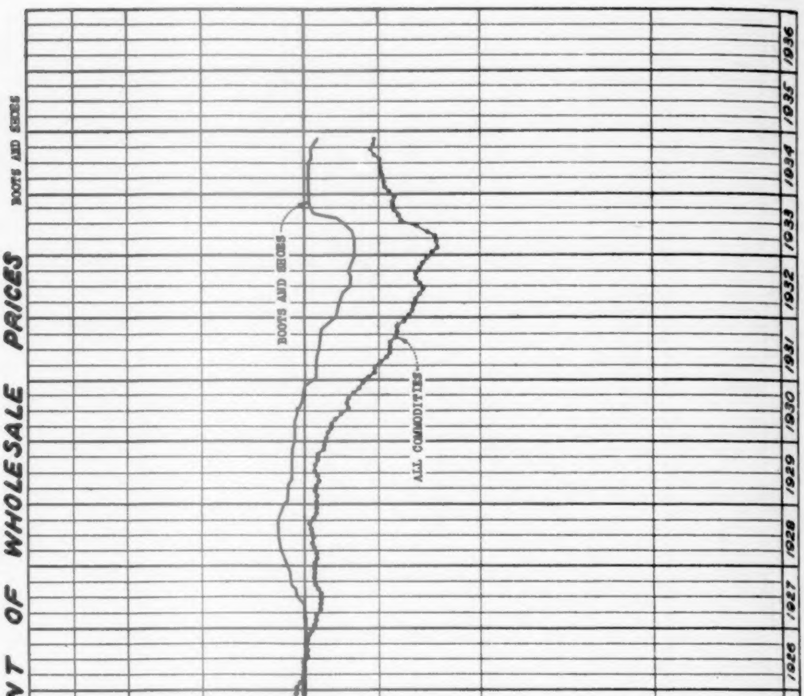
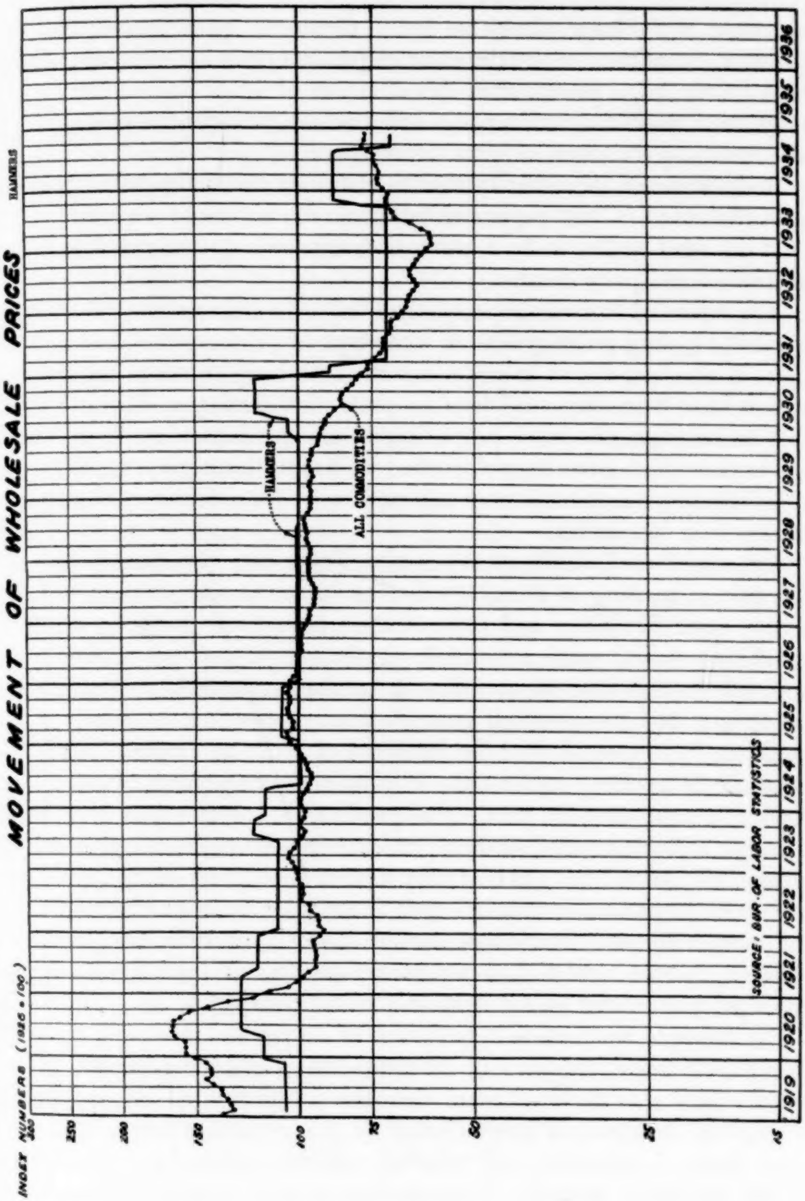

MOVEMENT OF WHOLESALE PRICES
SIDE LEATHER: BLACK CHROME TANNED: B GRADE
INDEX NUMBERS (1926 = 100)
300
250
200
150
100
75
50
25
15
SIDE: BLACK: CHROME
ALL COMMODITIES
SOURCE: BUR. OF LABOR STATISTICS
1919
1920
1921
1922
1923
1924
1925
1926
1927
1928
1929
1930
1931
1932
1933
1934
1935
1936

CHART VII



phenomena. The fact that the conclusions logically drawn from the use

CHART VIII



dition recovery and I do not wish to minimize their importance. The time

phenomena. The fact that the conclusions logically drawn from the use of this criterion are generally in accord with the known facts about concentration and price control tends to give an increased validity to the criterion. If the large plants are found to survive as compared with small plants in those areas where the value of product per wage earner is relatively high in the large plants, then this criterion of advantage in size seems to have some predictive value and a status which it might not otherwise have as explaining the cause of what takes place.

It is, however, desirable further to elaborate the statistical analysis. The data presented in this paper are rather in the nature of a preliminary report on what seems to be a promising approach to the problem of concentration and price control.

The Effect of Price Control on the Welfare of Consumers. The fact that there is a basing point system or some type of price control does not mean there is no competition in price, but the following charts in the industries which have been discussed tend to show that during a depression prices fall more from the level prevailing in the predepression period in the industries which have been described as having least price control.

This point has already been referred to by Dr. Means and has been illustrated in his charts.

Effect of Price Stability on Production. Some data have been presented by Dr. Means tending to show less decline in production in those industries where price flexibility and price decline have been greatest. While this conclusion would seem reasonable on theoretical grounds it would seem desirable to elaborate the proof so as to show separately its application to production and consumption goods instead of treating them only in combination. It is possible that the problem of recovery from depression can be made to appear simpler than it is by such a combination of different groups in estimating the elasticity of production. It seems quite possible that there is a difference in elasticity of production with price change in different groups of commodities and that the problem of recovery in the capital goods industries in particular requires special attention because of its relation to the market for the flotation of capital securities and because of the time elapsing in that field before an overproduction of facilities can be duly absorbed and related to the current demand for output.

For example, the decline in the prices of copper and zinc pig were heavier than the decline in the price of all commodities and the shipments of these commodities also declined more than the production of all commodities; a situation in apparent contradiction to the general principle that heavy price decline is attended with relatively smaller decrease in consumption.

The automatic working of certain factors such as price declines, surplus funds, and low rates of interest in promoting recovery has been possibly overemphasized in the past. These factors are generally believed to con-

dition recovery and I do not wish to minimize their importance. The time lag, however, which major depressions have shown in the working out of these forces seems to have been underemphasized. The importance of overcapacitation developing partly out of the contraction of foreign trade and mistaken investments in the field of the capital goods industries in their relation to the time required for recovery in this field has possibly been underestimated. The absence of satisfactory data makes it difficult to make statistical studies lending support to this suggested possibility. There is, however, sufficient knowledge of the development of overcapacitation to justify raising the question as to its possible importance as a cause of delay in recovery of capital goods industries.

Price Flexibility and the Recovery Movement. If the analysis of this paper is correct the causes of price rigidity or price control phenomena are entrenched rather strongly in the present state of the arts as they affect the production of goods. These facts have developed under a status of comparatively free enterprise. Given the present status of the mechanization of production, concentration and control tend to develop along certain lines as indicated in this analysis. It is not intended to infer that nothing can be done about this, but it is intended to infer that these developments take place under a system of comparatively free enterprise. The results certainly require close attention by the government and an understanding of the pricing system which develops in each industry where a high degree of concentration takes place.

It is not within the scope of this paper to do more than to set up an analysis of the underlying technological factors having to do with the business and price situation prevailing in various industries. It is probably true that in many industries even where there is a high degree of concentration the competitive price system still works well while in some others there may be a question. It may be true that in some industries, such as cotton goods, there is need of relief by way of modifying the rigors of competition as it now operates, while in others the prevailing price system may create an undue stabilization of prices, and justify some public attention in the way of attempt to modify the system which prevails; but it is necessary for me to content myself at this time with an effort at analyzing the causal factors with which one must deal in an approach to this problem.

DISCUSSION

FREDERICK C. MILLS: As we begin to get at the essence of any problem, we are likely to find that it loses the appearance of simplicity that it may have first possessed. We find complexities, involutions, differences that we never suspected, and that baffle us while they stimulate and fascinate us. This, I think, is the beginning of wisdom in economic research—the sloughing off of false simplicities and the facing of many-sided reality. We all have some pangs when the simplicity fades, for our minds yearn for a nicely-ordered and not too complex universe. John A. Hobson, somewhere, mildly deprecated the work of some investigator on unemployment, with the remark that he had wrecked the unity of a great problem.

If the discovery of complexity be on the path to true understanding, we have made some progress on that path in this session. We have seen some of the involutions and convolutions that inhere in the price field, and that are revealed under intensive scrutiny. Of course, we hope to go beyond these, to find order and an approach to simplicity after some of the tangles are unraveled, but we hope that it will be a simplicity that inheres in reality, not alone in our conceptions and rationalizations.

The fact of complexity beneath an apparently uniform surface is perhaps brought out most vividly in Dr. Thorp's paper. We have learned something of value from his realistic discussion of the complications that trouble the price analyst. We will do well to give far more attention than we have done, in the study of price movements, to the details of the price structures of individual industries. It is an arresting and disturbing fact that many of the changes that occur in the actual prices at which goods change hands are not reflected at all in the quotations currently compiled in official sources. This is particularly true, I think, during periods of violent change. We have constructed, at the National Bureau, index numbers of the prices actually realized by manufacturers, and these show some interesting contrasts with the index numbers of quoted prices of manufactured goods. Relative changes are similar, during fairly normal times. From 1929 to 1933, however, when quoted prices fell by only 25 per cent, the index of realized prices shows a decline of 34 per cent.

Dr. Bell's paper brings home to us the institutional character of price rigidities. In mechanization, heavy overhead, and all that they entail are found some of the most compelling causes of price rigidity. The economic characteristics of an industrial economy, rather than original sin, seem to be primary factors of this problem. This is not to say that there is not some trace of original sin in the situation. Perhaps if we could take a representative set of corporation accounts and boil them down to their essence, the final precipitate might contain some trace of this sin. I say this, not as an indictment of accountants, but because accounts are the presentment of reality that the business manager knows. The picture that accounts give tends to become reality to the harried executive and his board of directors. It may be that the picture they see in the mirror the accountant holds up to them is largely fabricated of the conventions of accounting, rather than of economic reality. The conventions of accounting may not be the best basis for price-making policies.

There is no opportunity here for a proper discussion of the meaty paper Professors Epstein and Sumner have submitted. I would, however, call attention to the implications of one illuminating remark. "An examination of the behavior of both prices and profits within each group [industrials and public utilities] suggests that the primary economic forces at work relate to differences in costs and in markets," the authors say, implying that differences in respect of regulation played a less important rôle. The conclusion that we must not ignore the distinctive economic factors affecting costs and marketing operations is applicable, I suspect, over a wider range than the samples covered by Epstein and Sumner. When we compare price and production changes occurring among different categories of goods, we are apt to read causal implications into the differing relations we find. The prices of capital goods are maintained in depression, and production falls; the prices of consumers' perishable goods are cut, and production is maintained. These differences in price behavior are highly important, and disturbing, but it does not follow that they account, in a causal sense, for the production changes noted. Numerous forces related to costs and markets, to conditions of production and of consumption, affect volume of output and prices. We do not get at the heart of the problem if we ignore these differences, and interpret varying production movements with reference to price changes alone.

I had no opportunity, I regret, to read Dr. Means' paper prior to the meeting, and I shall comment on it only briefly. He has suggested that a further rise of prices to the 1929 level, pivoting about the inflexible elements, should give us an approximation to an acceptable set of price relations. A study of price changes, historically, makes one very hesitant, I think, to accept the price system existing at any given time, 1910 to 1914, or 1929, as one which could or should be restored. What is normal in the price situation is not a fixed set of relations, but a set of relations that are constantly changing. The picture one gets is of a fan-shaped set of lines radiating from a point that represents the situation at a stated date. Accordingly, even if we could restore the 1929 price system, it would be a system ill adapted to the conditions of 1935. In fact, the 1929 price structure belongs to history. We cannot recreate it, either by controlled or uncontrolled inflation.

The papers we have heard clearly demonstrate, I think, the need of detailed, accurate, realistic studies of price changes, by industries. The rôle of overhead charges stressed by Dr. Bell needs study, but intensive study, directed toward the problems of specific industries. The complexities of the price structures of individual industries, which have been discussed by Dr. Thorp, call for similar first-hand investigation. Nor should economists alone attempt these studies. The aid of technicians, accountants, and merchandising experts is indispensable in such undertakings. A combined attack gives promise of results of inestimable value to economists.

The presence of rigidities in the price structures of modern industrial economies has, of course, been clearly established. The qualifications respecting discounts, trade terms, and quality changes modify the contrast between flexible and inflexible prices, but they do not alter the essential fact. But I would make one point, in closing, concerning our interpretation of this fact. Much of the present apprehen-

sion that centers about the presence of non-flexible elements in the price system is stimulated by the comparison we inevitably make between an economy marked by price rigidity, and all that goes with it, and a flexible, self-regulating economy with a perfectly free price system. The fact is, of course, that no such economic system ever existed, this side of the economist's Heaven. Rigidities, inflexibilities, administered prices we have always had with us, along with prices determined in greater or less degree by the play of competition among buyers and sellers. The area of competition has doubtless expanded and contracted, but it is probable that truly competitive prices never formed more than a small minority of the prices at which goods and services have actually changed hands, through the ages. And that includes the era of industrial and commercial expansion of the nineteenth and twentieth centuries. Some eight years ago the National Bureau of Economic Research carried back to 1890, and published, a series of measurements of the frequency of price change, of the type that reveal such a sharp contrast between flexible and inflexible prices. It is, I think, a highly significant fact that the frequency distributions for the decade of the nineties, forty years ago, show the same characteristic U-shape that is found in distributions for recent years. Indeed, the skewness toward the side of the rigid, seldom-changing prices was even more pronounced in the nineties than in the most recent period covered by Dr. Means' study.

We have all, I suppose, with more or less vehemence, criticized classical economists for constructing an unrealistic model of a functioning economy. But if the old masters look down on us now from the seats of the blessed (or the damned), they must be moved to ribald laughter. For in our study of price rigidities we seem to have taken at its face value, as a system to contrast with our own, that idealized Newtonian state of balanced forces, fluid adjustments, mobile productive agents, flexible and freely adjustable prices which we have elsewhere damned as a fantastic abstraction. We may not throw away our cake and have it, and that is what we appear to be doing when we contrast the rigidities of contemporary life with the fine, free, competitive, self-adjusting economy that we at once dismiss as fictional and pretend to have left behind us. We never had it. And we do not throw light on the real and pressing problems of adjustment that confront us by assuming that that particular millenium once existed. Indeed, we may find reassurance, looking out at our own tangled, buzzing confusion, in the knowledge that it never did exist.

FRANK G. DICKINSON: The time allotted to me will be devoted to four ideas or points made in one or more of the four papers presented at this session.

1. The use of the term "rigid" is somewhat unfortunate because few, if any, prices are rigid and unchanging; changes in the prices of manufactured goods are more difficult to measure because improvement in the quality of the commodities may be made without any price change. Number 4 yellow corn in Chicago in 1929 was almost the same kind or quality of corn as that of today; but the price of a 1929 automobile is the price of a quite different item from a 1935 automobile. In order to use a term which covers the field of slowly changing prices and, at the same time, recognize the statistical illusion of rigidity in the prices of products whose quality is changing from year to year, I prefer to use the term "sticky" prices—that is, sticky in a chronological sense—

and sellers may offer their commodity at either different or "uniform" prices at any one time or day.

2. These papers have stressed commodity prices. In the larger sense, rent, profits, interest, and wages are prices, especially the latter two which are truly costs of production. Manufactured products involve large investments of capital in plant, equipment, and wages; the resulting prices are, therefore, more likely to be sticky. In agriculture, rent looms large; rent is a "flexible price" because rent is a surplus. It is quite probable that many of these sticky prices are due to rigid costs. There are several kinds of rent, several rates of interest, and many rates of wages; they influence manufacturing and agricultural prices in many ways. Why are freight rates sticky? Do farmers have to pay such sticky prices to their laborers as the railroads do? Is the rate of interest on long-time loans to be condemned because it is a fixed and not variable rate or price?

3. Dr. Means has referred to "the disruption of the law of supply and demand," a phrase favored by journalists but usually not found in treatises on the economic theory of value; and we are told that sticky prices are evidence that this law no longer operates in a large sphere of our buying and selling activities.

If I understand Böhm-Bawerk, Alfred Marshall, and the other great masters of economic theory, one must go to the margin to examine the interaction of the forces of supply, demand, and price. Can anyone successfully contend that this interaction of supply, demand, and price did not bankrupt thousands upon thousands of producers of sticky price commodities during the last five or six years? If marginal producers were driven out of business, were the forces of supply, demand, and price inactive, inoperative, and disrupted at the margin? Price affects the demand, whether that demand is elastic or inelastic; price affects the supply whether produced under the laws of increasing or diminishing costs; and supply and demand affect price. If these forces bankrupt thousands of producers and if the holders of depreciated stocks and bonds in reorganized corporations which are now or were formerly producers of sticky price commodities were articulate, they would strenuously object to the inference that the so-called "law of supply and demand" did not operate in their economic spheres.

The marginal producer may be eliminated by either decreased sales or decreased prices or both. It has been demonstrated that our industrial population suffered slightly more than our agricultural population between 1929 and 1932. Agricultural prices decreased greatly while agricultural production in 1932 was practically as large as in 1929; industrial prices declined a little while industrial production was cut approximately in half. If we consider that income can be represented by the product of price × volume, the income for agriculture in 1932 was a higher percentage of the 1929 figure than the like percentage for industry. It is somewhat misleading, however, to use only two selected years in making such comparisons; these facts seem to indicate that virtue—that is, flexible price—has its own reward.

4. I seriously question the strategy of transferring the argument from the somewhat narrower field of monopoly to the broader field embracing sticky price commodities in the condemnation of our economic system; confining our atten-

tion to the monopoly problem is a much safer procedure. (Dr. Means grants that monopoly prices may be either rigid or flexible.) Some would place a halo about flexible prices and call them virtuous; from the same point of view, sticky prices are sinful and iniquitous. Such a moral implication is likely to prove a boomerang.

During the long periods of falling prices—say one-quarter to one-third of a century—the flexible prices seem virtuous to the consumer. We are now in the third of such periods, the other two having followed the Civil War and the War of 1812. In the periods of "rising" prices preceding these war-time peaks, the consumer has considered flexible prices sinful; the imminence of another period of rising prices makes this observation relevant to this discussion. If the inflation hopes of Washington (and the fears of New York) are realized, the sticky prices will become the virtuous prices because they will move upward more slowly. Could we not reasonably expect that when the price level again moves upward those who now indiscriminately condemn sticky prices, whether monopolistic or not, will urge the Congress and the President to levy a tax, similar, perhaps, to the present processing tax, but for the benefit of the producers of the virtuous sticky price commodities? It will be quite embarrassing to be forced to call flexible prices sinful and iniquitous and praise even the monopolistic sticky prices.

The great liberal economists, as for example, Frank A. Fetter, have pointed the way in restricting their brilliant criticism to the problem of monopoly prices. The business philosophy manifested in the NRA—whose authorship, in the light of the recent volume by General Hugh S. Johnson, can no longer be charged to college professors—must be thoroughly renovated and purged; if there had been no NRA, the gap between these two kinds of prices would have been narrowed. If this purge is to be accomplished, any embarrassment accruing from appraisals of the virtues of either sticky or flexible prices should be avoided. The work of men like Fetter must be continued; if the effort is spread over the large field of all sticky prices, that effort will be less successful and some monopolists may even be considered virtuous during periods of rising prices; and even now Dr. Means would praise any monopolist who uses (virtuous) flexible prices.

Again, I question the strategy of shifting the attack from the somewhat narrower field of monopoly prices to the broader, heterogeneous field of sticky or rigid prices; the problem of monopoly prices remains before us whether these monopoly prices are rigid or flexible.

H. L. McCRACKEN: One might be led to conclude from the paper by Dr. Thorp that modern price schedules are so intricate that it is impossible to distinguish a flexible price from a rigid price. However, so long as we have statisticians versatile enough to write such a paper, I am going to assume that they will be versatile enough to recognize them in whatever garb they appear.

The paper presented by Professors Epstein and Sumner on regulated and nonregulated prices is guilty, I think, of a major error in classification. They seem to have taken it for granted that the only regulated prices are those controlled by governmental fiat. All others are treated as nonregulated. A more accurate classification would be as follows:

1. Governmentally regulated prices.

2. Internally regulated prices.
3. Freely competitive, nonregulated prices.

In Table VI of their paper they list 47 corporations with "nonregulated prices" for their products. Among them are United States Steel and Bethlehem Steel.[1] Can anyone familiar with Pittsburgh Plus say that the prices of steel are not regulated? Yet, Pittsburgh Plus is only a classical example of a large number of prices internally regulated by private enterprise.

Due to the many trade associations and price agreements by private enterprise, the evidence submitted by Epstein and Sumner does not prove what they thought; namely, that many nonregulated prices seem to be as rigid as regulated prices. What it does show is that private enterprise, if allowed to organize compactly and fix quotas and prices, may do it quite as effectively as under direct governmental regulation. Their findings would have been far more helpful had they compared the genuinely nonregulated prices with those regulated, either by government or by internal price agreement.

note

But the main issue in this discussion is this. Would our industrial system function better if the flexible prices were made more rigid, or if the rigid prices were made more flexible? Both Dr. Means and Mr. Bell have argued that the flexible prices should be made more rigid. Mr. Bell has argued that because overhead costs increase with the expansion of horse-power energy and mechanical equipment, competition becomes destructive, and price agreement or administration is essential to the prosperity of the industry.

I wish to challenge Mr. Bell's contention unequivocally. The great danger arising out of an expansion in the size of industrial plants and more complex capital equipment is that competition will not be keen enough to drive prices downward as fast as improved technology drives costs downward. The reason why technological unemployment is so great and unutilized raw materials so perplexing a problem, is not because the greater use of machinery with attendant "bigness" in size of plant makes competition so keen and disruptive, but because competition is not keen enough to drive prices down with costs and make possible the enlarged consumption.

On this point I am in complete agreement with Colonel Ayres, of the Cleveland Trust Company. In his bulletin for August, 1935, he observes how the volume of consumers' goods has held up while prices declined severely, and how the volume of producers' goods has declined greatly while prices declined little. He then says, "If anyone could devise a means to make durable goods follow the pattern of consumers' goods in volume and prices during depressions, he would have found the solution of the depression problem, and he could tell us how future periods of seriously hard times could be avoided. It is the most important problem in the world." Clearly, the remedy is more flex in the price and less flex in production—more competition and less price-fixing.

When the American people are ready to turn their backs upon the monopolist's formula of "economic stabilization through price stabilization" and turn their faces toward the competitive formula of "stabilized production through price flexibility," our depressions will become shorter and less severe.

[1] This material appeared in footnotes to the Epstein-Sumner paper.

THE REQUISITES OF FREE COMPETITION

By HENRY C. SIMONS
University of Chicago

The requisites of free competition are the measures and policies necessary to survival of our established economic and political institutions. In putting this construction on the topic assigned to me, I am following, not only my own inclinations, but also the suggestion of the program committee.

My task is that of restating and presenting for discussion a position which I outlined some time ago in a pamphlet, under the subtitle of *Some Proposals for a Liberal Economic Policy*. Time permits only a sketching of that position and only meager reference to specific proposals. I shall try to define basic objectives; to describe a comprehensive policy; to translate general proposals in terms of proximate objectives and specific measures; and to criticise the current drift of policy and opinion. Attempting all these things, I shall be successful in none of them. But my function is merely that of opening discussion.

The preservation of freedom is, I submit, the most important end of policy and the most promising means to other valid social objectives. Abhorring violence, revolutions, and dictatorship, I believe that we must choose between freer competition and increasing political control and that, for real policy, the choice lies simply between a competitive system and authoritarian collectivism. Compromise schemes, and the so-called American compromise especially, are mirages luring us away from everything we really prize.

There are many routes back to authority. We may abandon economic and political freedom, either deliberately, or merely by continuing to drift, to temporize, to experiment, without any policy at all. To preserve liberty, however, and, indeed, to protect all those things whose recent accretion defines human progress to modern minds—to this end a positive economic program and a sharp alteration in the long-established course of governmental policies are indispensable. And the insights of old-fashioned economic liberalism point the only possible way.

The more proximate objectives of a traditionally liberal economic policy, under modern conditions, may be defined in terms of the problems: first, of money; second, of monopoly and regulation; and, third, of inequality. These objectives I shall try to describe concretely. The proposals involved are radical, of necessity; a conservative policy now demands radical implementation. What is requisite, however, is not drastic measures, but only a radical redirection of policy and the pointing of legislation toward definite long-term objectives. Repudiating gradualism, one repudiates the whole

liberal faith. The proposals which follow must therefore be regarded as defining a direction of policy, rather than as prescriptions for drastic reform.

I. Monetary Proposals

A. The establishment of definite, stable, legislative rules of the game as to money or, in other words, the creation of a national monetary system which will minimize monetary uncertainties and provide a definite, secure basis for monetary anticipations.

B. The sharp focusing of responsibility for observance and execution of the monetary rules.

These two proposals may be interpreted to mean, among other things:

1. Repudiation of central banking and, in general, of all schemes involving monetary authorities (dictators) with discretionary, policy-determining powers;
2. Establishment of the monetary rules as a sort of extra-constitutional mandate governing budgetary practices of the central government. (The monetary rules must be implemented through, and in turn must determine, fiscal policy.)

C. Financial reform (banking reform primarily) aiming at sharp differentiation between money and private obligations.

Increasing concentration in the hands of the central government of the power to create money and effective money-substitutes. (By money-substitutes I mean all obligations which are widely acceptable, not only for use as circulating media, but also for use in cash reserves or hoards.)

This is not the place to defend what some of you regard as a crank scheme of banking reform. A few general remarks must suffice.

We must abandon and avoid a financial system under which funds actually invested in production and trade are, at the same time, legally available to creditors on demand or on short notice. Not only must we prevent the periodic multiplication of money substitutes; we must also face the fact that substantial liquidation of investment is inherently impossible, and remodel our permissible financial practices accordingly. Practical solution may be found merely in narrow limitation upon the borrowing powers of private corporations and in withdrawal of the special status which the state, through special charter, regulation, examination, guarantee, and innumerable other measures and policies, has conferred upon the obligations of banks.

A main reason for radical banking reform lies in the prospect that banking, if it persists in its present form, will be nationalized or, at least, subjected to increasing governmental regulation, the result in either case being political control over the direction of investment. If we could separate sharply between the function of issuing money, the function of warehous-

ing and transferring funds, and the function of mobilizing funds for investment, then government control over enterprises performing the latter function (or the last two functions) might easily be confined to the provision of ordinary safeguards against fraud, and the threat of political influence in the allocation of investment funds, minimized.

Monetary reform invites emphasis in this discussion, for it is both urgent and especially promising. Given release from a preposterous financial structure, capitalism might endure indefinitely its other afflictions; but, assuming continuance of our financial follies (which, without definitive rules of policy, are inevitable), it becomes academic to consider how the system might be saved.

The immediate necessity is the reduction of monetary uncertainty—the adoption of a generally acceptable rule of policy, through which it may be possible to prevent the chaotic financial boom which credit expansion and dishoarding now imminently threaten. A rule calling for stabilization of some inclusive commodity-price index—and, I should urge, at its present level—offers the only possible escape from present chaos and the only promising basis for a real monetary system in the now significant future. Given such a rule, we might obtain salutary fiscal and central bank action which otherwise will be politically impossible. The long depression has only put us in the mood to draw and quarter anyone who, wisely, would deny us the stimulation of an exciting prosperity. But a rule might save us from ourselves where nothing else will.

Monetary reform can be immensely salutary without being drastic or disturbing; and the political situation is relatively favorable. We have now no monetary system at all, and have never had anything that deserved the name. The reactionary position on monetary questions is weak—though weaker intellectually than politically—and our friends on the left, fortunately, have no position at all.

II. Monopoly Proposals

A. The deliberate creation and preservation of competitive conditions in all industries where effective price competition is possible.

There must be vigorous and vigilant prosecution of conspiracy in restraint of trade and, above all, thoroughgoing reform in corporation law. The right to charter large corporations must be vested exclusively in the federal government; and the powers conferred on these legal creatures must be carefully and narrowly limited. (From the viewpoint of practical reform, both our monopoly problem and our financial problem have to do largely with abuses of the corporate form, i.e., with the careless, extravagant dispensing of corporate powers.)

Sharp separation must be made between operating companies and investment trusts, with restrictions and prohibitions designed to confine the ac-

tivities of each class of corporations closely to its own special, separate sphere. Operating companies should be denied the right to own securities of other such companies; and elaborate precautions should be taken, both against interlocking control, and against practices among the investment trusts which would tempt or permit them to influence the price and output policies of other corporations. Operating companies must be limited in size, under special limitations prescribed for particular industries by the Federal Trade Commission, in accordance with the policy of preserving real competition.

Among persons whom the Administration and the press have recently elevated and transferred to the status of leading economists, such proposals are ridiculed as products of a horse-and-buggy mentality, and condemned as calling for sacrifice of the economies of mass production. But no sane advocate is asking for perfect competition; and no critic who is at once fair and competent will picture the policy as requiring drastic change in the organization of production. The requisite changes have to do mainly with ownership units and control devices, not with operation. There would be a breaking down of enormous integrations into more specialized firms, with ownership separation among phases of production which are now largely separate in place and in management. For horizontal combinations, the policy would require ownership separation among operating units which are now connected by little more than common advertising and selling organizations. The need for organized, jointly-financed industrial research can be met by special arrangements. If there are cases where real production economies require units too large for effective competition among them, some sacrifices ought to be made in both directions; indeed, one finds here a reason for proposing the generally objectionable expedient of an administrative authority with some discretionary power.

The other monopoly proposal I will submit in two forms.

B. Increasingly sharp differentiation between industries requiring and enjoying governmental control of prices and all other industries, and the narrowest limitation of the former category.

Avoidance of the regulation expedient, as a permanent solution for the railroads and utilities, and, above all, the utter repudiation of this expedient as a feasible, tenable compromise between socialization and free competition for other industries.

Given current trends of legislation and opinion, this is the important and distinctive article of a liberal creed.

III. Proposal Regarding Inequality

The reordering of government expenditure (including subsidies, explicit and implicit) and of taxation, deliberately for the purpose of diminishing greatly the prevailing inequalities of wealth, income, and power.

The promising measures to this end would include: adoption of a broader and less casuistic definition of taxable personal income; closing of enormous, obvious loopholes for avoidance of progressive taxes; establishment of a normal tax rate of, say, 20 per cent; sharing of federal revenues from the personal income tax with the states; and abolition of all excises, save the gasoline taxes, from federal and state tax systems.

I should like to discuss the first two suggestions in detail; but I can only append here a few general observations:

1. Along the above lines, current sentimental liberalism finds its only safe and appropriate outlet.
2. The reduction of inequality, as an object of reform, can and must stand on its own feet. As a means for increasing purchasing power, for preventing overproduction, overinvestment or oversaving—whatever those nice words may mean—it is utterly ludicrous; and to consider it seriously in this light, is to reflect innocently and unwittingly on purely monetary problems, and to study fantastic implementations for monetary policy.
3. It is urgently necessary for us to quit confusing measures for regulating relative prices and wages with devices for diminishing inequality. One difference between competent economists and charlatans is that, at this point, the former sometimes discipline their sentimentality with a little reflection on the mechanics of an exchange economy.

To these three main objectives of liberal policy, I will now add two others which, while subsumable under the other three, deserve special attention.

IV. Proposal Regarding Foreign Trade and Agricultural Policy

Gradual but complete abolition of the gigantic federal subsidies implicit in our tariff structure and rapid termination of subsidies and production control for agriculture.

Tariff reform, as a main step toward liquidation of the growing political interference with relative prices, seems utterly imperative. So long as internal trade was substantially free, tariff legislation might be regarded as a somewhat harmless outlet or catharsis for all the antisocial, pork-barrel, log-rolling propensities of our political leaders and representatives. Now, however, if the whole field of internal prices is not to be opened up to orgies of political manipulation and democratic corruption, the practice of special legislation on behalf of particular producer groups must be attacked on the whole front, and in its traditional applications especially. The open season on consumers must be abolished; for, if the direction of tariff changes is not reversed, we cannot hope to prevent wholesale extension of tariff politics into interference with internal trade. The NRA is now, I hope, only an unpleasant memory; but we cannot rely upon the Supreme Court

as our only protection against the suicidal proclivities of representative government.

With freer foreign trade, the maintenance of effective competition in domestic markets would be much easier, and would require much less severe limitation on the size of corporations. Sound monetary reform, moreover, would greatly weaken the familiar apologies for tariff handouts and facilitate tariff reduction—and this is perhaps the place for some further remarks on monetary policy.

The stabilization of a price index at its present level would permit us to maintain indefinitely both free export of gold and the present gold price. Such a combination of arrangements, indeed, would invite deliberate recourse to a continued lowering of our tariff wall as a means for preventing any further accretion of our enormous gold hoard, for trading off the greater part of our monetary gold for something useful or remunerative, for promoting recovery in countries which have some need for gold, and for improving both world trade and the temper of international relations. Such a program would also serve, incidentally, to confine the gains from our recent debasement mainly to producers of our export staples. If, under established monetary rules, further reduction of our tariff eventually becomes incompatible with free export of gold at the prevailing price, tariff reduction should be continued and the gold price and exchange rates allowed to seek their own level.

My fifth and last proposal might be classified as another monopoly proposal; and it obviously exposes me to the charge of defining a policy merely in terms of its ends.

V. Proposal Regarding Merchandising

Recognition of the enormous waste of resources in advertising and distribution and of the awful bewilderment of consumers as a major problem of public policy.

For discussion of this problem I have neither time nor competence. The main opportunities lie in organized consumer education or, as a poet friend puts it, in the development of protective coloration for the buyer. But one may be hopeful of other changes: the development of consumer co-operation and (more important) of agencies, governmental and private, for informing and advising consumers; the development of standard specifications, standard testing, uniform grades, and accurate and informing labels for consumer goods. There is much that governmental agencies can do, especially by way of facilitation and encouragement, to promote these and other movements toward efficient distribution.

Returning now to the subject of regulation, I must comment very briefly, if only because of the strain involved in obeying the dictates of polite discourse.

In my pamphlet, I suggested early transition to government ownership for the railroads, and gradual movement in that direction with the other utilities. Candidly, I feel that our situation with respect to these industries will always be unhappy, at best; and I have no genuine enthusiasm for public ownership. My advocacy of the change is motivated primarily as an attack upon the notion, now common in high places, that our arrangements with respect to the railroads provide a simple and admirable model for the control of other industries generally. This is the substance (if any) of recent oratory on the subject of industrial planning, and the essential position of the prominent advocates of "bigness controlled." This plausible compromise between competition and collectivism is merely an alluring mirage along a downward course from which there is no returning; and it could be conceived and proposed, out of intelligence and insight, only by an ardent fascist.

A London economist, criticising my position, has suggested that complete and unregluated monopoly is preferable to government ownership for the railroads. Waiving quite trivial dispute, I should add "and clearly preferable to regulation for other industries." Unregulated, extra-legal monopolies are tolerable evils; but private monopolies with the blessing of regulation and the support of law are malignant cancers in the system. The conception of regulation as a device for protecting the public against monopoly exploitation is significant, in the real world, mainly as an apology for governmental enforcement of minimum prices and wages at levels higher than monopolies could maintain without the support of law. (It may be interesting here to recall that railroad regulation used to be regarded as a means for keeping rates down.)

I am, indeed, not much distressed about private monopoly power. Given sound monetary and banking reform, our institutions could survive, and the system thrive, against an enormous amount of private racketeering. Serious exploitation could be prevented merely by suppression of lawless violence and of grossly unfair competition (in the pre-NRA sense of that phrase). Labor organizations, of course, may depopulate and deindustrialize our metropolitan areas and force us to abandon transport over steel rails; and enterprise organizations may impede economic progress. But the ways of competition are devious and its vengeance—government intervention apart—will generally be adequate and admirable.

The real monopoly problem thus derives from the prospect that the state rarely will permit private monopolies to bear the consequences of their own actions. Monopolists will run to the government for protection against any threat to their unstable equilibrium, just as they always have done in the face of competition from abroad. The government is thus likely to be drawn into the enforcement of fair minimum prices; and, incidentally, among all the vague conceptions of popular, political economics, there is

none quite so misleading, treacherous, and subversive to sound policy as the conception of "fair price." Competition, once long suppressed, threatens awful disturbance when it reappears, and calls for readjustments which, while clearly required for the general welfare, are too painful for legislatures, with their infinite solicitude for articulate minorities, to endure.

This is the compelling reason for stamping out private monopoly. For every suppression of competition gives rise to an apparent need for regulation; and every venture in regulation creates the necessity of more regulation; and every interference by government on behalf of one group necessitates, in the orderly routine of democratic corruption, additional interference on behalf of others. The outcome along these lines is: an accumulation of governmental regulation which yields, in many industries, all the afflictions of socialization and none of its possible benefits; an enterprise economy paralyzed by political control; the moral disintegration of representative government in the endless contest of innumerable pressure groups for special political favors; and dictatorship. (I omit inflation, calling it a symptom rather than a disease.)

If you can envisage these things only in a distant future, I would remark that the United States is part of a larger world, and I would remind you of the recent silver legislation and, more emphatically, of the Guffey-Snyder bill, which, incidentally, is the perfect case in point for my whole argument on monopoly and regulation. If such legislation can be pardoned on grounds of apparent expediency, the responsible leaders can vindicate themselves only by testifying to awful moral decay in the system and to awful errors of policy, however remote in origin. And if anyone believes that these beginnings picture unfairly the potentialities of an economy of planning, of organized negotiation, and of regulation, he is not burdened with political insight.

Against all apologies for tariffs and for recent legislation, economists may submit, as generally decisive, the presumption that any price or wage which requires the support of force or law is relatively too high; and others may join us in observing that, in a democracy especially, force and legality must be economized. Thus, the fundamental issue, for liberals, is the same old issue of protection, of governmental intervention on behalf of particular groups and against the community. If we cannot now create and maintain a powerful moral pressure against use of the power of the state on behalf of organized producer minorities, the game of representative government is up. This, I hope, epitomizes and explains the whole position which I have tried to present.

Our monetary problems are conspicuous and intriguing; but here, as with the problems of inequality and merchandising, liberal reform faces no great obstacles. There is here no strongly adverse drift of policy or opinion—only intellectual confusion and hesitation. In opposing political control of

relative prices and wages, however, liberalism defines itself and its own, and perseveres in its discouraging struggle—against powerful, cumulative historical trends; against the vested interests of innumerable sheltered minorities; against the persuasive sophistries of mercantilism, new and old; and against the efforts of its own misguided friends.

The stakes in this contest are now tremendous. The future of the liberal faith and of the democratic ideal is now in American hands. And, ignoring factors far outside my competence, I submit that the choice we make between freer competition and increasing regulation of prices and wages will largely determine whether we lead Europe out of the valley or follow it down and down.

MONOPOLISTIC COMPETITION AND PUBLIC POLICY

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I

I shall discuss some aspects of the relation between monopolistic competition and economic welfare and point out some of the problems which must be faced if we are to evolve a public policy based upon recognition of the realities of economic processes. For several reasons I shall not attempt to outline a positive program as Mr. Simons has done. In the first place I do not here consider either the serious political problems concerned with government control of economic activities, or other non-economic elements in the general problem. Secondly, I restrict myself to one phase of the economic problem; that is, monopolistic competition. Finally, I do not treat the consequences of monopolistic competition for some important aspects of economic welfare, such as the distribution of wealth and income, while I can do little more than allude to other consequences.

I have chosen the topic "monopolistic competition" rather than "imperfect competition" in order to emphasize the fact that I shall treat imperfections of a monopolistic nature. In the actual world, elements which impair perfect attainment of that particular type of equilibrium of supply and demand forces identified by the classical economists with free competition, may be monopolistic or non-monopolistic. Imperfect knowledge, specialization, and durability of equipment and labor and of "business administration" are imperfections which may exist with or without monopoly. Monopolistic elements are found in conditions which endow any seller or group of sellers with sufficient control of supply to exert an appreciable influence upon some or any of the fundamental relations of the market—the relations between investment, output, price, earnings, employment, and demand. Influence is possible (in other words, monopoly power exists) where the number of sellers in a common market is small enough, where there is an agreement wide enough in scope, or where the product of one seller is successfully differentiated from those of others. Monopoly power inheres in fewness of producers even in the absence of differentiation, and differentiation gives elements of monopoly even though a large number of firms produce articles which are closely similar. Pure competition, or the absence of any monopolistic elements whatever, obtains where the individual seller is unable to affect appreciably any of the fundamental relations of the market. For example, under pure competition a seller could not have a price policy.[1]

Professor Chamberlin and others who have developed the theory of

[1] When buyers are few, monopoly elements exist on that side of the market. Discussion in the present paper is limited to monopolistic competition between sellers.

monopolistic competition call attention to the undeniable fact that competition and monopoly are not mutually exclusive. They point out that substantial monopolistic elements exist side by side with competitive elements in many, perhaps most, markets (or industries), and maintain, of course, that the particular sorts of equilibria, both short- and long-run, which exist in such markets are determined by the interaction of monopolistic and competitive forces. The contrast between this view of the economic system and the traditional view is a decided one, and the two contrasting views lead, as far as purely economic considerations are concerned, to distinctly different principles of public policy toward industrial organization and business practices.

II

The traditional view of the economic system as evidenced in economic theory and the pre-War and earlier post-War trust literature was briefly as follows.[2] There were a few "natural monopolies" where competition was held to work very badly for all concerned owing to exceptional peculiarities of technological conditions and financial structure. These peculiar conditions were not considered to be present in consequential degree in the great majority of industries. It was maintained that in these so-called "competitive" industries, unless one firm came to control a very large part of the total output—say 60 per cent or more—"competition" would, in the absence also of imperfections other than monopoly, actually approximate the results long supposed to ensue from the competitive process. There would be no monopoly profits, no underinvestment, no continuous underutilization of what was considered the ideal amount of investment or of any greater amount. Some believed that combinations controlling a very large proportion of total supply would be unable to exercise their monopoly power to any appreciable degree as long as potential competitors were free to enter. Others maintained that dissolution of the trusts was desirable. Nearly all favored extinction of all methods of competition which promoted the growth of trusts not based on superior efficiency. These theories implicitly or explicitly contained a belief that in all industries except the few natural monopolies the benefits of competition could be obtained without sacrificing any advantages of efficiency as related to the scale of the business unit.

An implication of traditional theory is of interest in connection with questions of variety of product and competition. The long-run competitive equilibrium described a situation in which all firms were most efficiently organized and operating at their most efficient rates of output. Price was equal to average full cost at its minimum point on the U-shaped cost curve of the individual firm. The erroneous implication was that consumers might have whatever variety of product they desired without any sacrifice in pro-

[2] I recognize with regret that the needs of brevity force me to do some violence to those theories.

ductive efficiency. Again, the significance of selling costs for the allocation and utilization of economic resources went unanalyzed.

In summary, economic theory and trust literature pointed to the competitive equilibrium—which we should now call the purely competitive equilibrium—as a state in which consumers obtained both the advantages of large-scale efficiency and as much variety of product as they wished and also the full benefits of the competitive process in yielding ideal investment, best utilization of equipment, normal earnings, and hence the optimum price, in all those industries regarded as "naturally competitive."[3]

The principles of public policy proceeding from these views called for government intervention of limited scope. Natural monopolies should be regulated or owned and operated by government. If dissolution of combinations in other industries was required at all, it should be confined to those combinations, certainly a minority, which attained something approaching nearly complete control of supply. Competitive methods which did not truly measure efficiency should be eliminated; and, by implication at least, any other barriers to free entry except those inherent in differing personal qualities or ability to obtain capital should also be removed. Since the significance of variation or differentiation of product and of selling costs was generally neglected in the explanation of competitive equilibria, no important problems of public policy with respect to these matters were envisaged.

Twenty years ago public policy concerning competition and monopoly had come in the main to accord in abstract principle with this view of economic processes. A few natural monopolies were subjected to rate regulation. Regulation of investment and earnings followed. Outside this limited sphere business was liable to the anti-trust laws. It seems to me that in so far as there was any central concept or theme in the interpretation and administration of the anti-trust laws, it was the preservation of the freedom to compete. Obviously this did not mean the preservation of what we now call pure competition, or even of anything very nearly resembling it. It meant simply that each firm was to be free to determine its own policies independent of others and that neither the entry of newcomers nor the success of existing firms should be blocked or hampered by oppressive tactics. The anti-trust laws did not, I think, make monopoly illegal. Rather, the thing condemned was monopolizing or restraint of trade, both of which seem to have meant achieving or trying to attain nearly complete monopoly in an industry by a course of combination for which no justification in greater efficiency or normal expansion could be found; or by destruction or weakening of existing competitors or blocking of potential competition by the use of bludgeon-

[3] Discussion of various qualifications to this general proposition, such as that of Professor Pigou concerning industries of diminishing and increasing cost, is outside the scope of this paper.

ing, harassing, or obstructive tactics rather than competitive methods which measured relative efficiency in production and marketing. These laws and their interpretation represented the expression in the economic sphere of the philosophy of liberalism, the belief that the most desirable institutions, ways of life, allocation of economic resources, distribution of wealth and income, and so on, would obtain if a large measure of freedom from government interference was preserved to the individual. By 1914, public policy in abstract principle had been brought fairly well into accord with the view of economic processes presented by economists. It cannot be said, however, that effective freedom to compete was preserved in all markets. This seems to have resulted from the failure, common to both economics and public policy, to realize the significance of "power politics" in economic activity. Economic theory assumed that profits were to be made and losses avoided chiefly, if not solely, by superior efficiency. The late promise of a realistic and salutary development of the law of competitive methods held out by the 1914 legislation has for a variety of reasons turned out to be largely a boomerang. Public policy seems to have overlooked such important barriers to free entry as control of scarce resources of raw materials, lack of pure competition among investment bankers, and the impressive formidability of size and length of purse supplemented by industrial and financial affiliations.

Let us now contrast with the traditional view of the economic system and the public policy which in the abstract, at least, came to accord with it, the view presented by the theory of monopolistic competition. The policy of preserving freedom of competition in all but a few industries actually resulted in considerable freedom to business to free itself from the compulsion of the competitive market. There seems to be little doubt that monopolistic elements throughout the economy have increased since passage of the Sherman Act in 1890. When account is taken of the co-operative experience during the War and the subsequent growth of trade associations, the merger movement of the twenties, and the development of advertising and other devices for differentiation, it appears quite likely that monopoly elements have increased since 1914.

The traditional picture of the economic system is challenged by the theory of monopolistic competition in several other important respects. Wherever monopoly elements exist, the results of monopolistic competition may diverge from the sort of equilibrium contemplated by competitive theory. Under certain circumstances divergence is desirable; under others, undesirable. We first consider instances of desirable divergence. The theory of monopolistic competition emphasizes the significance of variation or differentiation of product. Successful differentiation confers some monopoly power by attracting a clientele which has some preference for the article of a particular seller. Given differentiation, competition is likely to result in less efficient rates of output and higher prices than those described by the

equilibrium of competitive theory, although earnings may not be above competitive profits. In so far as consumers really want the variety of product which is the basic reason for this condition, the ideal competitive equilibria of traditional theory would not adequately meet their wants. What would appear to be monopolistic exploitation according to the familiar criterion turns out to be a symptom of greater precision in the satisfaction of wants. To the extent that advertising expenditures—which could, of course, have no *raison d'être* under pure competition—enable attainment of a larger maximum of satisfactions, the same is true of them also. Again, in many industries efficiency might be far below the attainable maximum if the number of producers were large enough so that no one could affect the relations of the market. Finally, it may be that the persistent creation of overcapacity in some industries composed of large numbers of small, ill-informed firms can only be prevented by a reorganization of the industry which brings an increase of monopolistic elements in the form of fewer firms or the conclusion of agreements. Destruction of all monopoly elements would result in what would doubtless be regarded as intolerable standardization and probably in some considerable reduction of efficiency. The problem is to preserve that degree or those sorts of monopoly power which yield desirable results and to destroy or sterilize the excess monopoly power which may, as we shall see, bring unfortunate consequences.

In so far as differentiation of product is carried beyond the degree which would really be desired by consumers if they had complete and accurate knowledge of products in the market, the national income suffers.[4] Assume that articles roughly similar in physical attributes are produced by any number of firms, each of which differentiates its product by brand, packaging, advertising slogans, and the like. The result may be underinvestment and monopoly profits in varying degree to all. But in so far as others can produce what is in essentials the same article and differentiate it to some extent, existence of monopoly profits will attract an inflow of resources; whereupon, if all producers attempt to maximize profits, the result will be overinvestment, underutilization, and no more than competitive profits to some, perhaps all. There is, of course, no more reason to expect that the extent of variation which comes into existence is automatically restricted by competition to the ideal amount, than there is to suppose that competition never permits combination to exceed a size which is just right for maximum efficiency. It is quite possible that the aggregate of monopolistic wastes in what would formerly have been called the general body of competitive industries greatly exceeds the wastes of trustified industries.

Again, when sellers of the same article are few, and when each evaluates prospective demand and supply conditions in about the same way as the

[4] It is impossible here to go into the relations between differentiation, advertising, knowledge, and wants.

others and coolly pursues the policy best calculated to maximize his profits in either the short run or the long run, the quantitative market relationships are almost certain to differ from those contemplated by competitive theory. If entry to the field is effectively barred, underinvestment and monopoly profits may result without any agreement. If entry is free, there is a tendency for profits to be brought down to normal by an influx of newcomers which creates overinvestment. Under such circumstances underutilization of capacity may be substantial. If the few rivals engage in determined price competition, however, results will approximate the relations described by competitive theory, unless earlier attempts to hold prices up have attracted enough capacity to create overinvestment.

The existence of substantial monopoly elements also confers the power to discriminate in price between markets which can be separated. It is probable that monopolistic discrimination is much more widespread throughout the price structure than economic literature would indicate. And finally, there may be undesirable divergence from ideal market relationships due to monopolistic agreements, which are sufficiently familiar in principle.

Enough has been said to indicate some of the more important possibilities under monopolistic competition of undesirable tendencies in market relations. The extent of actual divergence from ideal market relations depends upon degrees of monopoly power, elasticities of demand, cost conditions, and the way in which sellers act. Divergence as measured by monopoly net revenue per unit of investment, by extent of underinvestment, or by underutilization of economic resources may be greater in an industry comprising ten firms no one of which controls 15 per cent of the output than in an industry where one firm sells 75 per cent of the total volume. Where substantial monopolistic elements are operative, competition does not automatically produce the ideal quantitative market relations contemplated by the theory upon which public policy has been based. That theory implied a very limited amount of government control of economic activity. The theory of monopolistic competition suggests that state interference, economically defensible upon either view whenever the net addition to income is likely to be greater than the cost of state action, may be required in a large number of markets, if maximization of national income is to be approached; and at the same time issues a warning that the use of monopoly power to add to the total income of satisfactions must be distinguished from its use to subtract.

One other exceedingly important aspect of monopolistic competition has been deferred to the end of the list because it does not slip easily into the categories used above and because it has received little theoretical analysis. I refer to the fact that existence of monopoly elements confers some measure of power to plan for the future; a firm can have an investment policy, a marketing policy, a price policy. When the enterprise which possesses the

power to plan is a corporation which looks forward to continuous existence and growth, it is likely that its policies will be determined by fairly long- rather than immediate considerations. Evidently the executives of many such enterprises believe that some appreciable stability of price contributes to long-run stability of profits or to some other desired objective. Without inquiring into the reasons for this belief or its soundness, we should note that such price rigidities must affect either the allocation or degree of utilization of economic resources. Conceivably the consequences may be good or bad, but there are cogent reasons for believing that in a majority of instances the national income is likely to suffer from such policies. It seems particularly probable that monopolistic price rigidities increase the severity of the business cycle. Even if there is no truth in the contention that serious maladjustments resulted from the failure of the prices of many manufactured commodities to decline in step with costs during the twenties, it seems most probable that price rigidities during the depression have tended to increase its severity and duration. More price flexibility might have increased output, consumption, and employment directly in the industries concerned; in any case the force of the impact upon other segments of the economy would probably have been diminished with the result of lessening the extent of bankruptcies, uncertainties, fear, desire for cash liquidity, redistribution of incomes, and shifts in demands.

III

I now turn to a brief survey of some of the problems which must be faced in order to develop a program for public policy which accords with realities. Such facts as we have indicate that monopolistic elements are extensive. Theory suggests that operation of some monopolistic forces may increase to some extent the consumers' satisfactions obtainable from our economic resources and that exercise of other sorts of monopoly power will reduce real incomes markedly. Unfortunately we know none too much about either the extent of monopolistic elements or their actual results; and we do know that some undesirable consequences, such as overinvestment, may result from non-monopolistic imperfections.

First, as to the facts of monopoly power. Much more adequate and accurate information upon the numbers and the relative importance of sellers in many different markets should be obtained. A survey of this matter upon which I am now jointly engaged with others has disclosed above all the meagerness of available data from which satisfactory results can be secured. This inquiry should, of course, consider foreign sources of supply and tariffs. The nature and extent of barriers to free entry needs thorough study. The prevalence of monopoly elements on the buyers' side also requires attention.

A second set of problems concerns the economic justification of monopoly

elements. More intensive study of the relation between size and efficiency and progressiveness is of crucial importance. We have little more than vague knowledge about the extent to which monopoly elements would be lessened if all firms were of the minimum size necessary for maximum efficiency, although there is reason to think that the diminution would be appreciable. The problem of distinguishing between those sorts and degrees of variation of product which better meet the wants of consumers and those which result in net subtraction is particularly difficult. Perhaps the most fruitful line of attack is in the direction of truthful advertising and the development by impartial agencies of standards of quality for all sorts of products.

A third range of questions has to do with divergence from ideal market relationships. We have noticed that when sellers are few there are different possibilities with regard to the relationships between investment, output, price, earnings, and demand. It depends upon the degree to which entry is free and the way in which sellers act. Thorough investigations of the facts in many industries of this sort are in order to discover which possibilities are more often realized. Under such circumstances is immediate advantage sacrificed to long-run stability of profits? Or do sellers act like pure competitors in their long-range programs of investment and progressive development of new adaptations of product, meanwhile pursuing monopolistic price and output policies? Monopolistic discrimination incident to basing point price structures has received considerable attention, but we need to know more about the extent of discrimination which takes the form of selling different, partially finished or finished products made from a basic product (such as a metal) at prices which after subtracting the conversion costs return different prices per unit of the basic product.

The problem of overinvestment and ruinous competition falls in this category. A large degree of monopoly is often urged as the best instrument for prevention or cure of overinvestment. In this there is some logic. When firms are few, with or without agreement, each is probably able to assess supply and demand conditions better than when sellers are much more numerous, and each has a greater incentive to do so since his policy will affect appreciably the conditions in the whole market. And once overinvestment exists it is obviously wasteful for additional resources of the same efficiency to enter the field. On the other hand a large degree of monopoly power may, unless successfully regulated, bring worse results. Prevention may be carried too far with the result of marked underinvestment. Cure may take the objectionable form of legitimizing excess capacity through enabling it to earn profits by remaining idle. Maintenance of high profits may attract additional capacity. Furthermore, as we have seen, the original development of overinvestment may be directly due to too much monopoly power. Again, in so far as overcapacity results from the introduction of more efficient equipment, it is, up to a point, a sign of health rather than disorder; for it

is more economical from the standpoint of the community to have old equipment partially operated as long as it can earn something above direct costs at some rate of output than to have it all replaced with new facilities. The ideal situation would, however, give the appearance of true overinvestment to the extent that the earnings of some firms fell short of normal returns on the original cost of all equipment. Is it not likely that some part of the complaint of overcapacity during the latter part of the twenties is to be ascribed to the rapid introduction of more efficient equipment? Finally, it should be remembered that the explanation of overinvestment may often be found in uncertainties and poor knowledge, in overoptimism, in the existence of corporate surpluses to which no one seems to have any very definite claim and which may, perhaps, be reinvested on grounds other than the rational pursuit of profit. To a large extent remedies different from greater monopoly power would seem to be appropriate. The whole matter of overinvestment and rationalization requires more incisive theoretical analysis and thorough examination of the facts in a number of industries.

Finally, I wish to emphasize the importance of the relation between monopolistic policies and the business cycle. Although monetary and credit policies can exercise a salutary influence toward reducing the magnitude of fluctuations in output, incomes, and employment, it is difficult to see how they can prevent or cure the substantial residue of maladjustments incident to monopolistic forces.

IV

These are some of the more important problems which must be faced if we hope to develop a program of public policy which accords with reality. It seems altogether probable that the degree of monopoly power which is justified either by considerations of efficiency or by consumers' desires for variety differs markedly between industries, and further that the actual existing divergence from the particular organization and policies which would correspond with the ideal degree of monopoly power also varies greatly between industries. A twofold or even four- or fivefold classification of industries is hardly likely to be consistent with the facts. Evidently different types of government intervention are appropriate for different industries or markets. It is highly questionable whether the policy of general rules for large numbers of industries should be continued. I believe we should work in the direction of separate codes for separate classes of industries, in some cases for single industries—codes which in every case apply appropriate principles both of organization and of business policies. Monopoly power should everywhere be adjusted as nearly as can be to that degree which seems economically justifiable. This may mean increase in some industries and decrease in others. Monopolistic policies or practices which rather definitely seem to yield no net social advantage should be abolished and effective steps taken to prevent their reappearance. Those familiar with

the none too happy results of regulation in the utility field will agree with me, I think, that a policy of getting rid of all that monopoly power which yields no net social advantage would be preferable to attempts to regulate its use.[5] In my view, for the majority of industries the problem is that of creating conditions such that monopolistic competition will be forced to bring results which approach much closer to the ideal market relationships than the actual results under the present public policy. Concretely this might mean much more serious economic surgery than ever occurred under the anti-trust laws, and codes which are more extensive and in certain respects more restrictive than those emerging from the Trade Practice Conferences of the Federal Trade Commission. It goes without saying that the codes should, in many instances at least, differ strikingly in content from those of NRA. Where it is impossible to create conditions such that monopolistic competition will function satisfactorily, government competition if carried out according to proper principles may be better than government regulation. The development of consumers' co-operation also has promising possibilities.

Formulation of any such program of public policy requires two things in particular. The development of practical criteria for economic control is imperative. This requires a social philosophy. Government control to deal with the problems here discussed must inevitably affect other elements in economic welfare such as economic security, the distribution of wealth and income, and the relative degree of economic freedom for different groups in the community, to say nothing of factors which are not strictly economic. If economists wish, in addition to describing the way economic processes work, to try to prescribe methods for increasing economic welfare, they cannot face the attendant problems devoid of a social philosophy which goes beyond economic considerations narrowly construed.

In the second place, a large amount of basic economic information about a large number of industries is manifestly necessary. We should have a grand taking of stock of the experience of many industries in the post-War period. Investigations by individual students and research foundations into the particular problems raised here suffer from the meagerness of pertinent information. There is need for a new edition of the Industrial Commission empowered to plan and carry through an extensive investigation and provided with legal authority to acquire the necessary information.

Before adding one more point in closing, I wish to reiterate that I say nothing about the political problems of getting a desirable economic program adopted and administered effectively and honestly. It will, of course, be impossible to devise and administer codes in such a way that ideal results are perfectly attained. The best practicable system of government control will still leave a large measure of responsibility with business leaders. Hence

[5] I imply nothing here as to whether or not the extent of monopoly power in any of the utility industries exceeds that which is economically justifiable.

it is of particular importance that the codes make clear to business men the guiding principles for distinguishing between economic and uneconomic conduct. The failure to add much in this respect to older legal rules has been one of the saddest aspects of the history of the Federal Trade Commission. If business men thoroughly understood principles for distinguishing between activities which promote economic welfare and those which act in the opposite direction, it is possible that business leaders might accomplish something in the way of developing an ethic of business concerning the use of monopoly power for the public interest. The conservatism of most business men and their apparent lack of ideas for sane economic change may reflect to an appreciable extent simply a lack of understanding of the social consequences of economic processes. Although substantial monopoly elements confer power over market relations, the use of which must affect the economic welfare of the community one way or the other, many business men may not understand very clearly how or why this is so, partly, perhaps, because the traditional ideas of the free market, of pure competition, have so dominated all thought about the consequences of economic activity.

It is becoming increasingly plain that the future fate of economic liberalism in this country will be determined in the fields of labor and industrial organization and business policies. Unless we are capable of discovering and successfully administering a public policy which will markedly reduce the opportunities for maladjustments due to exercise of monopoly power, and unless, also, industrial leaders who still possess monopoly power realize the implications of their positions and are willing to discharge the attendant social responsibilities of economic statesmanship, the superiority of that type of economic liberalism which we call free capitalistic enterprise and its ability to maintain itself for long in the future would seem to be open to serious doubt.

DISCUSSION

ABRAHAM BERGLUND: There are two tendencies often marking the formulation of economic laws or theories which expose them to much justifiable criticism. One is the tendency to make the application of a law or principle broader in scope than the facts warrant—a common fallacy in all scientific investigation. The other is a disposition to assume that an economic force operates with the same or similar effects irrespective of the nature of the units involved and the conditions determining their relationship to one another. Both these tendencies have marked much of the discussion concerning the scope and influence of competition in economic life.

Competition has always been a potent force not only in industry but in most phases of social life. It has also played an important rôle in the evolution of the varied forms of life now occupying the earth. Broad and potent as this influence has been, there have always been limits to its full operation. In economic life the play of competitive forces has been more or less restricted by various institutional growths or cultural traditions, by differences in the mobility of the factors of production, and by numerous trade barriers to the free movement of goods and services in both national and international commerce. Recent developments in industrial technique in several lines of business are favoring large-scale production. In some instances such growth has been accompanied by a pronounced reduction in the number of producing units. This reduction has facilitated the movement toward large combinations, both nationally and across national frontiers, capable of exerting a considerable measure of control over prices and output. Preventive measures against such monopolistic growths have largely failed. One evidence of this is the increasing number of commodities whose prices are fixed for long periods or fluctuate only within narrow limits with marked or even drastic changes in the volume of trade.

Furthermore, social forces do not always produce the same or similar results when applied to different units or varying relationships. The belief in the beneficent influence of competition unrestrained by governmental interference grew up and flourished in the late eighteenth and early nineteenth centuries, partly as as a reaction against old systems of state and guild regulations which had become obstructive with changing methods of production. No sooner, however, had capitalist enterprise been freed from these older restrictions than the need for new regulatory measures became apparent. Factory acts were passed to reduce the abuses to which labor was being subjected; other legislation was passed to prevent various discriminatory practices in transportation which prevented many concerns from marketing their products to advantage; court and commission rulings became necessary to curtail unfair trade practices. In other words experience has shown that competition itself needs a large measure of regulation in order to be a constructive force in industry rather than an influence favoring much in modern business that is purely predatory.

The papers which have been read here show the imperfect working of competitive forces under existing conditions. In Professor Simons' comprehensive analysis of the "requisites of free competition" there is much to be said in favor of the stress laid upon the preservation of freedom, provided we have a clear

understanding of what is implied by freedom in a social sense. Approval, I think, may also be given in general to his monetary proposals, his advocacy of vesting the right to charter large corporations exclusively in the federal government, and his attitude on federal subsidies implicit in our present tariff structure. I am inclined, however, to question the feasibility of certain monopoly proposals. For example, it may be well to differentiate between industries requiring governmental control of prices and other industries, but can this differentiation be made "increasingly sharp" when natural monopolies particularly in the field of public utilities seem to be expanding? Can the regulation expedient be avoided or severely limited in a period of large-scale production with pronounced tendencies in the direction of monopoly control? The question can also be asked are all organizations in the forms of holding companies, mergers, pools or cartels, shipping conferences, and the like, formed as they generally are for some sort of control over prices, necessarily prejudicial to the public interest? In our very complicated industrial system we have yet to determine the social significance of business policies aiming at some measure of price stabilization and industrial stabilization.

In the paper by Professor Wallace dealing with what he calls monopolistic competition—a phrase ordinarily regarded as self-contradictory—we have an illuminating treatment of the imperfect working of competitive forces under certain conditions of marketing. Monopoly, or partial absence of competition, exists "where the number of sellers in a common market is small enough, where there is an agreement wide enough in scope, or where the product of one seller is successfully differentiated from those of others." One phase of this monopoly control, not definitely expressed in the paper although in a sense implied in it, is its basis in public psychology—shown in the preference of consumers for certain brands or labels and the effect on the public of clever advertising. The complexity of the problems presented warrants, in my judgment, the author's statement that "evidently many different types of government intervention are appropriate for different industries and markets." If this seems too large an order for any governmental system to adopt, then I fear we shall have to conclude that we have developed an industrial technique which we are unable to control or use to the best advantage.

Speaking generally, competition within limits will probably remain, at least for a long time, a regulatory influence in industry—paramount in some lines, of less consequence in others. It is, however, only one such influence. Government interference of a regulatory nature and, in some instances, ownership and operation will be called for to safeguard the public interest.

The rapid development of large-scale production has brought forth another influence which is likely to have an important and, on the whole, a beneficent effect on future price policies and, indirectly, on wage levels. I refer to the influence of the rapid growth of machine technique in modern business. Not long ago Secretary Roper quoted President Roosevelt as saying, "The interests of what we broadly term business are not in conflict with, but wholly in harmony with, mass interests."[1] This statement may have been a party declaration of

[1] *The United States News,* November 18, 1935, p. 4, under the caption, "A Defense of Bigness in Industrial System."

harmony between the objectives of big business and presidential policy. It does, however, contain a principle of great significance in a machine age. It is the machine that is gradually making for moderation in the price policies of big business. While the fear of large-scale production as a predatory rather than a productive force has not been without some foundation, the machine, which has been a major influence in its present-day development, is in reality a true democrat, in the sense that it produces not for small or select groups of consumers but for the masses of consumers. Under the old craftsmanship, the most efficient producer served "the best people." The efficient machine with standardized output, on the other hand, produces for the masses and depends for its success upon a large public with relatively high purchasing power. We have here a force which even under monopoly control exerts an influence on prices similar to that which economists have assumed competition to exert. What we sometimes call "the law of diminishing costs" is a law which operates, at least in some industries, within very wide limits. While this law may not entirely supplant competition as a regulating factor determining price levels, it seems to me it is destined to play a large rôle in future business policy. It may not make the interests of business men coincide entirely with those of the general public, but it seems likely to prove on the whole a potent force in bringing about a wide distribution of the products of industry, and hence helping in the promotion of a greater industrial democracy. At any rate, we have a force which makes business success dependent upon a public with high purchasing power—in other words, a public representing a relatively wide distribution of wealth.

Arthur Robert Burns: In this session we are called upon to appraise changes in the technique of production, selling, business management and organization in terms of both economic efficiency and personal liberty. The events of the past two years have pointed threateningly in the direction of the questions raised by Mr. Simons. Among these events the National Industrial Recovery Act has, I think, been overmuch abused. It registered the general disillusionment concerning the anti-trust policy of the past forty-five years. It also revealed the influences most potent in forming state policy when the prohibitions of the anti-trust laws were virtually removed. It evoked from business men clear and forceful expression of their demands upon the state. Although a desperate social gesture, it gives to the question here under discussion a bitter realism.

One of the most painful reflections arising out of the papers we have heard is the question whether the discussion has been postponed too long to be fruitful. Mr. Simons refuses to believe that the technical difficulties of turning back are already too great, and I think I can best contribute to the discussion by confining myself mainly to his suggestions for restoring what he calls "real competition" in industry. To this end he proposes to limit the size of corporations in each industry and to prevent any co-ordination of their policies by eliminating holding companies, interlocking stockholding, and interlocking direction. The practical difficulties of preventing the co-ordination of policies should not be passed over without mention, but they are obvious and of minor importance compared with the difficulty of controlling the size of firms. The now well-established trade association may, however, prove a considerable difficulty and Mr. Simons

might find it necessary to return to Adam Smith and frown upon meetings of business men "even for purposes of merriment."

The maximum size of firms is to be set for each industry by the Federal Trade Commission which (to quote from Mr. Simons' pamphlet, *A Positive Program for Laissez Faire*) "must become perhaps the most powerful of our governmental agencies." This maximum size is to be set so as to secure "real competition." Competitive behavior is, however, partly a matter of the attitudes of individuals, and in some industries where there are relatively few firms one of them may prevent the remainder from exploiting the monopoly elements present in the market. Such individuals cannot be depended upon, however, to turn up in every market, and Mr. Simons relies upon a more general rule. In a footnote to his pamphlet he suggests as a tentative beginning that no firm should control more than 5 per cent of the output of its industry. This figure is admittedly arbitrary but there is at present not even a tenuous basis for calculating the number of firms necessary to secure competitive behavior. Conditions affecting freedom of entry, elasticity of demand and conditions of cost, as well as the attitudes of firms are, as Mr. Wallace has pointed out, among the factors influencing the operation of the market.

Mr. Simons has mentioned that the application of the rule requires the definition of an "industry." This admission points to a number of serious difficulties. Is the Lincoln Motor Company in the same industry as the Ford Company? Is rayon a near enough substitute for silk or cotton for it to be included in those industries? Even more important is the geographical definition of an industry. If the whole of the United States is regarded as a single market many industries in which production is geographically scattered contain many firms but also many local monopolies. There may be many bakers or milk distributors and yet little competition in many local markets. The ultimate destruction of tariffs would reduce the problem but the consequences would vary in different industries and different parts of the country. Finally, as Mr. Simons indicates, new industries and products would also require discretionary modifications of his rule. Efforts to translate his simple rule into specific application may reveal that "real competition" is as elusive as "restraint of trade."

The reduction of the sizes of firms may also be costly in terms of productive inefficiency. Mr. Simons is obviously correct in his statement that many large corporations control more than one plant, and that the number of firms could be increased without any increase in the number of plants by a mere change in the ownership and control of these production units. But these plants under common control frequently produce dissimilar products or products to be sold in different territories. Their separate management would, therefore, not always increase the probability of competitive behavior. While Mr. Simons doubts whether there is any widespread conflict between the organization of an industry necessary to induce competitive market behavior and the organization necessary to minimize the cost of production, Mr. Wallace has stated that "in many industries efficiency might be far below the maximum if the number of producers were large enough so that no one could affect the relations of the market." It must be sadly admitted that we have so little factual knowledge of the cost of

production in each industry that it is impossible to resolve this conflict of opinion. In view, however, of the geographical decentralization of production in a number of industries, and in spite of the "chain" type of competition, I suspect that there are many industries in which Mr. Wallace's conclusion is more valid than Mr. Simons'. A change in the size of firms would, moreover, involve costs of transition; industries would need to be reorganized and often relocated. The slower the transition the more these costs could be reduced.

Wherever firms attained the maximum permissible size, inducements to reduce costs and prices would be greatly diminished. Firms below the maximum size might seek business by price competition, but as their costs are likely to be higher than those of the larger firms they are not very likely to do so. This situation departs so far from the competitive that it is not unfair to say that the very heart has been taken out of competition. It is, moreover, doubtful how far it would be possible by increasing the numbers of firms to secure flexibility of prices. Where real production economies require units too large for effective competition between them, Mr. Simons is prepared to make a concession from his general principle of avoiding all discretionary power in the hands of governmental regulating bodies and to permit compromises. The automobile industry will doubtless be among the first to call for and secure a compromise. But such compromises cannot create "real competition."

Vertical combinations are to be permitted only so far as they are compatible with "real competition." The proposed limitation upon the size of business in terms of the amount of property controlled would permit the less integrated firms to operate on a larger scale in one stage of production than the more integrated. I doubt whether such is Mr. Simons' intention, but it is a difficulty easily removed by a reformulation of his rule. On the other hand, in so far as competitive behavior can be maintained in every market, one of the forces making for vertical integration would be removed and the problem of control simplified. But difficult problems would persist. If some of the firms in an industry could demonstrate to the regulatory commission that more economical methods of production were available if vertical integration were permitted, they would remove from the market some of the products previously sold. Would it then be necessary, in order to maintain "real competition," to require the remaining unintegrated firms operating in the earlier stages of production to reduce their scale of production to permit an increase in the number of firms selling on the market? To do so would be to stimulate vertical integration by firms whose special circumstances otherwise made it less desirable than for the firms initiating the reorganization. The regulatory commission must make difficult decisions involving considerable control over methods of production.

The attempt to limit the size of firms will therefore involve a very great deal of planning, as Mr. Simons remarks, sufficient to provide an outlet for much enthusiasm and idealism. He defends this centralization of power over the organization and location of industry and methods of production because it is designed to prevent extra-governmental concentrations of power and thus avoid more deliberate planning, with which he associates the promiscuous distribution of special subsidies and favors. But it is extremely doubtful whether he can by the means he proposes obtain both real competition and the economies of mod-

ern technical methods of production. The losses are likely to be considerable and wherever there is conflict the heart will be out of competition.

The major question is whether the price of greater personal liberty thus obtained is too high. It may, however, be easier than Mr. Simons suggests, although still far from easy, to move in the direction of strengthening the consumer interest so as to make the tug-of-war between the producer and the consumer a more equal contest. Vigorous governmental effort might be made to inform consumers concerning the manner in which the operation of the industrial system affects them. It might also secure able exposition of the point of view of the consumer in all governmental decisions affecting industry, and especially those concerning tariffs and public utility rates. Planning would then not so inevitably mean the final downfall of democracy. A consumers co-operative movement would also be a powerful lever if consumers were more receptive to the principle.

I am in substantial agreement with Mr. Wallace's analysis of the implications of monopoly elements, and especially endorse his remarks concerning the tendency to normal profits by way of rising costs rather than falling prices. I support most heartily his plea for another industrial commission to provide factual information concerning the policies of industry and their background. I also join in his condemnation of past policy in the control of public utility rates. The creation of conditions in which monopolistic competition will be compelled to yield results more nearly approaching the ideal market relationships than those resulting from the present anti-trust policy is an objective beyond dispute. Separate codes for different industries or groups of industries suggest a means of adapting general policy to the special conditions of each industry. Our present ignorance concerning industrial organization and operation justifies his caution concerning the specific content of these codes.

But Mr. Wallace's remarks concerning the major question posed by Mr. Simons are far from convincing. He recognizes the importance of "power politics" in the economic field as one of the causes of the failure of anti-trust policy in the past. But he hopes that organized business will accept codes which, expressing the public interest, conflict with the private interests of industry groups. He looks to the development of an ethic of business concerning the use of monopoly power as soon as business men understand the guiding principles for distinguishing between economic and uneconomic conduct. It is true that their lack of ideas concerning sane economic change may be partly due to a lack of understanding of the social consequences of economic processes, traceable partly to their belief in a vague and distorted version of the theory of individualistic competition. But I doubt whether appreciation of the broad social implications of their conduct will induce them to pursue the public rather than their private interest. They are not more heartless or rapacious than the rest of us, but the direct effects of their policies upon their private interests concern them more vitally than the remoter social consequences of their policies. The experience of the National Recovery Administration indicates that they have enlarged their horizon to take account of the consequences of their action upon others in their own industry. The considerations that have compelled this broadening of vision may continue to operate, compelling them to follow the repercussions of their acts into their remoter consequences in other industries and, possibly, back again

into their own. I see no reason, however, why development along this line should lead to a policy embracing the interests of society as a whole. While it might reduce many of the broader inefficiencies of business organization, it is not likely to result in the formulation of, or acquiescence in, the kind of social philosophy to which Mr. Wallace has properly referred as a prerequisite to public policy.

Mr. Simons believes present conflicts of interests to be so bitter and irreconcilable, as to be impossible of deliberate adjudication and compromise by any planning organization. Indeed, warfare among organized economic groups is likely to destroy representative government. It seems to me, however, that when Mr. Simons sketches his own program he fails to take account of these obstacles, so fatal, in his opinion, to planning. In a world in which economic interests are already organized, such proposals as the severe reduction of tariffs, limitations upon the size of firms, restriction of advertising, and, especially, reduction of the inequality in the distribution of income, involve also conflicts too bitter and irreconcilable to be resolved by peaceful means. The great possibilities of socialized consumption which he rightly envisages, also conflict, often seriously, with the principle of the minimization of discretionary planning; they also can lead to bitter conflict.

Liberty is very precious and is seriously threatened. But Mr. Simons' planning to minimize planning seems to me to lead inevitably to much discretion in planning, and to involve heavy social costs. It may be said that such is the price of freedom, but I doubt whether freedom can be bought at this price. The acceptance of more direct control of industry avoids the necessity of reversing streams of tendency that have flowed deep and strong for over half a century. More vigorous representation of the consumer interests seems to be the best hope for the permeation of the industrial system with a social objective and for the maintenance of such democracy as we have.

THE BANKING ACT OF 1935

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In the limited time available I shall deal only with some of the larger aspects of Title II of the Banking Act of 1935. This is the part which consists of the new amendments to the Federal Reserve Act about which the controversy chiefly raged last spring and summer. The violence of feeling was, I thought, quite out of proportion to the actual content of the proposed legislation. There was a disposition on both sides to regard the bill as more revolutionary than it really was. On the one hand, some of the more enthusiastic believers in a quantitative monetary control as a means of achieving economic stability were inclined to regard this legislation as marking a complete break with the past behavior and the past philosophy of the Reserve system. On the other hand, the critics were inclined to read into it fears that arose not so much from its actual content as from their own hostility to previous New Deal legislation and experimentation, particularly in the monetary sphere.

I

Title II is very short. The amendments which it contains are few in number. They divide into technical amendments concerning Reserve bank and member bank operations, and amendments regarding the administration of the system and its powers of credit control. They are based in part upon specific difficulties and problems of operation which had arisen during the depression, and in part upon a desire to modify the organization and to clarify the aims of the system in the light of the whole experience with it since 1913.

Of the technical provisions in the original bill, the most important were those relating to rediscounts and advances by the Reserve banks and to collateral for Federal Reserve notes. The bill proposed that all member bank assets should be eligible as a basis of borrowing from the Reserve banks, without discrimination as to types of assets, provided only that in the judgment of the Reserve banks the assets were sound. This amendment, which represented a very large and fundamental departure from the original Reserve Act, was based upon the emergency legislation already passed in February, 1932, in the Glass-Steagall Act, and was intended to incorporate that legislation, in an improved, permanent form, in the Reserve Act. The proposed amendment was of course a challenge to the adherents to the traditional commercial loan theory of banking which they were not slow to accept; but experience appeared to be on the side of the advocates of the amendment. Lombard loans had long been part of the familiar practice of foreign central banks. Our own experience in 1919-21 had shown that

"self-liquidating" paper is not liquid in emergency and, if excessive in amount, can finance a boom and lead to a depression. It was largely the experience of those years which led many business concerns to fight shy of loans from banks, with the result that commercial paper, already diminishing in relative importance even before the War, was reduced to only 12 per cent of bank assets by 1929, and is not more than 8 per cent at the present time. The depression showed that a contact of this extent between the Reserve banks and the member banks, even together with advances on government securities, may be inadequate in time of need. At the worst stage of the depression the banks found themselves either forced to dispose of sound assets by sale, contributing heavily to the general deflation and in many cases undermining their own solvency, or else forced into paralysis by reason of the frozen conditions of assets on which they could not realize at the Reserve banks.

There is not time to discuss in detail the merits of the commercial loan theory of banking. Many leading monetary theorists have long since discarded it. Robertson has undertaken to say in how far the "needs of trade" argument is valid. Though his analysis errs, I think, on the side of generosity to the argument in that he overstates the amount of working-capital loans necessary to satisfy the legitimate needs of trade, anyone familiar with the analysis recognizes how entirely at variance it is with the traditional commercial loan theory. Personally, I think that there is a valid and important distinction between current credit and investment (though this is not by any means coterminous with the popular distinction between commercial paper and bank investments or security loans) and that this distinction ought to play an important part in monetary and banking control. Control, however, cannot be made effective by attempting to dictate eligibility requirements for rediscount but by according to the central bank freedom and power to prevent banking excesses in any type of asset, whether that power be exercised by "direct action" control as is now possible with security loans, or by the more general methods of discount rate and open-market operations. There is no inconsistency between this view and the view that, to be of real service in time of need, the Reserve banks must be prepared to face the situation as they find it, to maintain a broad contact with the banks, and to extend to them accommodation on any sound asset without regard to type. The extension of the scope of the Reserve banks' lending operations was objected to by many on the ground that it would impair the assets both of the member banks and of the Reserve banks. In this connection, the record of experience under the Glass-Steagall Act is pertinent. Loans of over $300,000,000 have been made under Section 10b, under very adverse conditions, and all but $1,500,000 have been repaid. I am very glad that in the final Act this proposed amendment was substantially adopted, subject only to the provision that such loans as were not previously eligible should be

made at not less than .5 per cent premium over the highest discount rate, which proviso seems to me desirable.

Very differently fared the proposed amendment regarding collateral for Federal Reserve notes. The original bill proposed a general asset currency. The final Act eliminated this amendment entirely, so that the Reserve note stands exactly as it did before, except that the Glass-Steagall amendment of 1932 permitting the issue of notes against government securities remains in force under a Presidential proclamation until March, 1937. The main arguments against the proposed amendment were, first, that the restriction of collateral for notes to commercial paper in the original Reserve Act was intended to provide an "elastic" currency and, second, that the use of government bonds as collateral for notes might open the flood gates of inflation. Neither argument appears to me to have any validity. An elastic currency is secured by giving to the central bank the right of note issue, provided the member banks are not prevented from securing notes by restrictions as to the type of collateral which they may offer in exchange for notes. The fact that in 1913 we did both things, granted the right of note issue and specified a type of collateral, prevented our seeing that it was the former and not the latter which was responsible for an elastic note supply. As to the danger of inflation, two points seem pertinent. We have been operating since February, 1932, with bond-secured notes, and this surely has been a period when, as rarely in our history, people have either feared, or hoped for, a governmental inflation, but it has not occurred to anyone to say that there has been any evidence of any inflationary practice in the handling of Reserve notes. The theoretical answer is, of course, that the main safeguard against inflation taking this particular form is that we are a deposit-using country. From this point of view, it is rather absurd to have passed the other amendment admitting government securities and all other sound bank assets to eligibility for member bank borrowing of reserves, where they can serve as a basis for manifold expansion of deposits, and to have rejected the amendment broadening the collateral for notes.

How badly the restriction of note collateral to commercial paper can work in an emergency was illustrated during the depression. It is common knowledge that owing to the scarcity of commercial paper, the Reserve banks were forced to cover their notes by gold in excess of the minimum 40 per cent gold reserve requirement. This was the source of fears about a shortage of "free gold" in 1931-32, and also of Mr. Hoover's often reported statement that we were in danger of "going off gold." It was absurd that a nation with from four to five billion dollars of gold reserves, should have been in any danger of facing an actual inability to export gold without serious deflationary effects,[1] but at one time, the amount of gold tied up behind notes

[1] There is not space for adequate treatment of this situation. Actually, there was no inability to export gold. The member banks could always have got gold for export by redis-

was equal to 100 per cent of the amount of notes in circulation, and the amount of "free gold" got down to about $400,000,000. The Reserve banks, moreover, were deprived of freedom to buy government securities as a means of fighting the deflation by increasing bank reserves, because buying securities meant reducing rediscounts, which meant reducing commercial paper in the portfolio of Reserve banks, which meant tying up more gold behind the notes. It was, of course, not a coincidence that the Reserve bank open-market buying program, designed to create excess reserves, began only after the system's request for the Glass-Steagall legislation had untied its hands; and yet this particular lesson of the depression we apparently have not learned. The only change which I personally would have made in the original bill's provision for a general asset currency would have been to go further and remove the 40 per cent gold reserve requirement. This, too, for much the same reasons as have already been given, seems to me to serve no useful purpose in a deposit-using country—provided that it has a central banking system with a virtual monopoly of note issue—and to restrict unnecessarily its ability to defend its gold standard position. There is, of course, the further, and always important, question of the public interpretation of such a change, and of how far it is wise, in the absence of impelling necessity, for legislation to outrun the layman's understanding of the reasons for it.

II

It was, however, in the amendments affecting the administration of the Reserve system and its powers of credit control that controversy chiefly centered. There were three main questions: the relation of the Reserve system to the government, the relation of the Reserve Board to the Reserve banks, and the nature and aims of the powers of credit control. What was feared by many critics was that the Reserve Board was to be brought under the domination of the federal government, the Reserve banks were to be debarred from participation in credit control, and the control powers, after having been enlarged and centralized in a politically dominated Board, were to be used for new and revolutionary ends.

Here especially it is necessary to have in mind the general setting: the monetary experimentation of 1933-34, the agitation for inflation, the discussions of a "commodity dollar," the propaganda for a "Federal Monetary Authority," the rumors about studies of banking reform conducted in the Treasury, the fact that the new banking bill was introduced very promptly after the appointment by the President of a new governor of the Reserve Board. Actually, there was virtually no evidence in the original bill of a

counting commercial paper, which would have released gold tied up behind notes. But the effect of the member bank borrowing would have been to intensify the deflationary forces at work; and, as explained in the text, the Reserve banks were not free to offset such borrowing by open-market operations.

desire to weaken the independence of the Board, and considerable evidence to the contrary. To strengthen the personnel and the independence of the Board, it was proposed to increase the salaries of Board members from $12,000 to $20,000, to grant a pension of $12,000, and to insist that its members be qualified for their task by education and experience.

There was, however, a provision that a Reserve Board governor who resigned or was removed before the completion of the term for which he had been appointed should be considered to have completed his term as a member of the Board. The purpose of this provision was to make the governorship more attractive to a banker, by removing the restriction in the existing law which forbade any member of the Board who had not served his full term from entering the banking business until two years after his retirement from the Board. This provision was seized upon by the critics, who pointed out that it would enable a designing president to change the entire personnel of the Board by the simple device of advancing each member in succession to the governorship and removing him.[2] This criticism was made point number one in the "Economists' Manifesto" against the bill, which was signed last March by sixty-six economists. No single piece of criticism, I think, took the framers of the bill so completely by surprise as this one, or better indicated the general atmosphere of suspicion. This provision was promptly dropped, and the law allowed to stand as before.

In the final Act, by changes introduced in the Senate under the leadership of Senator Glass, the Secretary of the Treasury and the Comptroller of the Currency were removed from the Board, and as a further safeguard the Reserve banks were expressly prohibited from buying government securities except in the open market, though they had never in fact bought securities from, or otherwise made direct advances to, the Treasury.[3] These changes were all in the direction of strengthening the position of the system against governmental influence, and are therefore desirable. Yet they cannot, and should not, entirely free the Reserve system from that influence. There appears to be a good deal of confusion in the public mind as to the principles which should govern the relations of central banks to governments. Perhaps much of the confusion turns upon the failure to distinguish between "governmental" and "political" in a narrower sense. In so far as it is the duty of a central or regional banking system to influence the volume and the value of money, it is of course exercising an inalienable right of government and can do so only by reason of the powers and responsibilities delegated to it by the government. That in this sense the Reserve system was originally meant to be and has always been a governmental institution cannot be questioned. It is governmental also in the sense that in any great emergency, such as war

[2] A further important question involved in any such procedure would be whether the President has power to remove the governor arbitrarily or only "for cause."

[3] Except for the purely technical overdraft arrangement at the quarterly income tax dates.

or a major depression, its activities must be in sympathy with and must support the national plan of action for meeting the emergency. That this is true has been proved by the history of central banking in all countries, regardless of the precise legal details of their relations to government, the character of their capital ownership, or any other considerations. The power of central banks to influence the national plan of action at such times rests in the last analysis not so much upon independence from government control as upon their prestige and powers of persuasion.

While any central or regional banking system is and must be governmental in this broad sense, it has always been recognized as part of the tradition of central banking that its function is distinct from that of governmental fiscal policy, for example, or from the aims of any particular group or faction, or even from any particular administration, which is inevitably subject to political pressures and to the transitory expediencies of its own fiscal necessities; and that for such reasons it is wise for the government deliberately to set up barriers of protection for its central banking system, barriers which permit it to function within its own sphere reasonably free from such considerations. One major means of accomplishing this purpose, it seems to me, is to do whatever is possible to strengthen the personnel of the Reserve Board and to increase its status and prestige; and this was clearly intended by the framers of the original bill. But in the final Act, though there is, I believe, substantial improvement over the existing law, the salary provision was reduced from \$20,000 to \$15,000, the qualification of education and experience for Board membership was dropped, and the provision for pension was eliminated. As the matter now stands, Board members are not even included in the Reserve system's own retirement allowance plan.

In the proposed amendments concerning the powers of credit control, the purposes for which, and the agencies by which, they should be exercised, there was much more room for serious differences of view. This was the real heart of the debate. The original bill proposed that the Reserve Board be granted the power to change reserve requirements, and this power is granted in the final Act, subject to two restrictions, that required reserves may not be reduced below their present amount, and may not be increased to more than double their present amount. About the need of granting this power, in some form, there was no difference of opinion. It had already been granted, though for a different purpose, by the Thomas Amendment of 1933, subject to the qualification that the President must announce an emergency to exist. This qualification is now removed and the Board is given power to alter reserve requirements, within the limits specified, in order to prevent injurious credit expansion or contraction. The immediate purpose of this provision presumably was to enable the Board to alter reserve requirements as a means of sopping up the extraordinary volume

of excess reserves created in the past two years by gold inflow. Presumably, this power will be used, and surely it should be used, not as an instrument of short-period credit control, for which it would be much too rigid and hazardous, but only at rare intervals when it is necessary to make a fundamental readjustment of required reserves.

The real debate therefore was on the purposes for which the general credit control powers of the system should be used and the agencies by which these powers should be directed. The original bill proposed a mandate which would substitute for the old phrase, "to accommodate commerce, industry, and agriculture," a statement that the control powers should be exercised with a view to maintaining economic stability, in so far as that objective can be achieved by monetary means. The mandate was purposely couched in very broad terms to make it clear that it did not mean necessarily price stabilization or imply any other specific formula. With this mandate, as it was stated in the bill, I was in sympathy. It was almost exactly similar to the mandate in the charter of the new Canadian central bank; and in fact most of the newer central banks have such a mandate. It seems fairly clear that the main intention of the original Reserve Act was to create an agency for the more effective maintenance of an adequate and sound supply of credit; and it was not until after the War that the boom and depression of 1919-21 indicated clearly that the maintenance of a sound and adequate supply of credit involves a responsibility for the control of the supply of credit in the interest of general economic stability. The Banking Act of 1933 gave the sanction of law to the maintenance of sound credit conditions as a goal of Federal Reserve policy, and in so far as the present bill was intended further to clarify the purposes and responsibilities of the Reserve system in this regard, I was in accord with this intention. The statement suggested seemed at once sufficiently definite, sufficiently broad, and sufficiently safeguarded against claiming for credit control more than can be accomplished by it. At the same time, I think it ought to be pointed out that there is, after all, nothing new in this statement of objective. The Reserve system has undoubtedly been actuated for years in its major credit policies by a desire to promote general economic stability, and since the War it has increasingly given thought to the technique of quantitative control, as indicated, for example, by its development of the open-market operations. Two facts may have been chiefly responsible for the omission of the mandate: first, the fact that the more enthusiastic advocates of quantitative control were inclined to overstate its efficacy, and also inclined to picture it, as embodied in this proposed mandate, as representing a much more complete and revolutionary break with the past behavior and philosophy of the system than it really was; and second, that the idea of attempting to achieve economic stability by monetary means had become associated in many minds with the idea of price stabilization, which many economists, including myself, regard

as a questionable formula. The omission of this mandate in the final Act and the substitution for it of the words, "with regard to their bearing upon the general credit situation of the country," seem to me to be of no great importance. After all, in the future as in the past, the control that is exercised will depend more upon the personnel of the controlling body and upon their understanding of the problem than upon any specific form of words.

The really crucial question is that of the agencies that should exercise these control powers, which raises the question of the relations between the Reserve Board and the Reserve banks. This question came to a head in the debate concerning the composition of the open-market committee. There were three proposals advanced by various interests: to leave the open-market committee as at present, where the initiative lies primarily with the Reserve banks; to give the open-market powers entirely to the Board, with an advisory committee composed of governors of the Reserve banks; and finally, to create a new open-market committee composed of Board members and governors of the banks.

Open-market operations have been a post-War development; they were not regarded as a major instrument of policy when the original Federal Reserve Act was passed. From small, informal beginnings, whose significance was at first not fully appreciated, open-market operations have gradually come to be recognized as a principal instrument of monetary control. Owing largely to the circumstances of their origin, first as individual operations of the separate Reserve banks, designed in the beginning merely to supplement the earnings of these banks in periods when rediscounts were diminishing, and then, as their effect on bank reserves and the volume of member bank credit was realized, as operations conducted, at first by an informal self-appointed committee of the governors of the eastern Reserve banks, and later by this same committee after approval by the Reserve Board, these operations, though they are distinctly national rather than regional in purpose and effect, have remained in practice chiefly under the control of the regional Reserve banks. As the matter has stood, prior to the present Act, which goes into effect on March 1, the Open Market Committee has consisted of the governors of the twelve Federal Reserve banks; the Reserve Board has had a power of veto, but has not ordinarily initiated open-market policy and has not at all adequately participated in the discussions of the Open Market Committee. Moreover, the boards of directors of the individual Reserve banks could vote to refuse to participate in the operations, even after they had been decided upon by the Open Market Committee and approved by the Reserve Board, though this did not in practice prove a serious limitation.

In establishing our present system of twelve co-ordinate Reserve banks and a Federal Reserve Board in Washington, the purpose was to create a regional rather than a central banking system. All will agree who recall the

very thorough study of this question in the period prior to the passage of the Act in 1913 that there then seemed to be very sound and convincing reasons for the decision that was made—the size of our country, and the diversity of economic interests; the considerations which have guided us from the beginning of our national life in our desire to retain a proper balance between local and federal government and to avoid a centralized bureaucracy of government; the fact, which no other nation has had to deal with in creating its central banking system, that the political capital of the nation is not its economic capital. These reasons for a regional system are quite as compelling today as they were in 1913.

On the other hand, both logic and experience suggest that if the Reserve system is to be an effective agency for credit control, as well as for credit supply, in the national interest, there is need for some greater degree of centralization of the powers of credit control than was provided in the original Reserve Act. Our chief problem, in my judgment, has been how to provide this desirable and necessary degree of centralization of authority without impairing the regional character of the Reserve system. I entirely agree that a change is warranted from the original conception of the Reserve Board as a board of review of the policy decisions of the Reserve banks, without power to initiate changes in policy. Such a conception tends to put something of a premium on the Board's powers of obstruction and to deprive it of the opportunity, which it should clearly have, to take affirmative, constructive action. This conception has tended also to create both diffusion and confusion of responsibility in matters of major credit policy. It is a system which, by its very nature, makes for cumbersomeness and delay, and which tends to crystallize and to make unnecessarily rigid those differences of judgment which inevitably to some extent arise in periods of stress when questions of major credit policy are most difficult to solve and most urgently require solution.

On the other hand, to give the major credit powers of the Federal Reserve system entirely to the Board would, I feel certain, destroy the regional character of the system and greatly diminish the effectiveness of its operations. Effective credit policy requires continuous contact with the money market, which the Board in Washington cannot be expected to maintain; and it must take into account the actual effects of national policy decisions upon the various parts of the country, which the Board in Washington would be ill equipped to do. Nor do I believe that the advantages of the regional organization can be retained if the regional units are reduced to what amounts to agency status, and are deprived of real authority and responsibility. The quality of the boards of directors and of the official personnel of the banks inevitably would tend to run down; the type of ability now available at the Federal Reserve banks, both among the directors and the officers, would be lost in large measure to the system.

The paramount need of the Reserve system, in my judgment, has been the provision of an effective means of bringing the Reserve Board and the Reserve banks together at a common council table. This, to my mind, is the only correct and workable solution of our peculiarly difficult problem of achieving a banking system which is at once regional and national, which can act promptly and with a minimum of friction. I therefore believe that the provision in this new Act which creates an Open Market Committee consisting of the seven members of the new Board of Governors of the Reserve system and of five governors of the Reserve banks is conceived on the right lines. This arrangement provides a clear majority for the Board, as I think should clearly be the case, and also ensures participation by the Reserve banks, not in an advisory capacity but as responsible colleagues. This arrangement is based in principle upon the original bill as first introduced into the House. The further question might be raised whether it might not have been better to assign all of the major credit powers to this committee, not only open-market operations but also the power to review and determine discount rates and the power to alter reserve requirements and margin requirements on security loans, which powers now are to be vested in the Board. As matters now stand, there is still some room for lack of co-ordination of policy.

III

This paper does not pretend to be a complete analysis of the new banking Act, or even of the Federal Reserve amendments in Title II, but it has covered most of the main points that were in controversy. On the whole, I regard the Act as constituting a substantial improvement in the organization of the Reserve system and clarification of its responsibilities. How the system will function, however, will, I think, depend in the future as in the past more upon its personnel, their understanding and judgment, than upon the specific legislative provisions.

In conclusion, it ought to be pointed out that the creation of central bank machinery, however soundly devised or directed, is not a substitute for a good commercial banking structure. That, in my judgment, is the fundamental lesson of the last twenty years, and particularly of the depression. Our chief need is not reform of the Federal Reserve system but the much more fundamental reform of our commercial banking structure, organization, and practice. That this is true would seem to be fairly obvious in view of our record of bank failures, even in good years, and in view especially of the collapse of our banking system during the depression. It is surely no coincidence that, whether we look to countries with central banks or to countries without central banks, we can find no record of bank failures since the War comparable to our own. It would therefore seem logical and sensible to consider the problems of commercial banking and to decide to

what sort of commercial banking system the Reserve system should be adapted, before undertaking major changes in the Reserve system itself.

There was perhaps an opportunity at the time of the bank holiday to effect some fairly sweeping reforms of commercial banking, but I doubt if that is true today. It seems more probable that improvement will have to come by a more gradual process. For the time being we must recognize that the banking system has been substantially strengthened by the program of capital rehabilitation which followed the bank holiday, and probably also by federal deposit insurance, which by Title I of the Banking Act of 1935, is put in an improved and more permanent form. Having the kind of banking system that we do, it seems necessary also to have deposit insurance, though it would seem much more desirable to improve the banking system itself than merely to protect the depositor against its defects. The present Act does take a step toward unification of the banking system by requiring that all banks with deposits of $1,000,000 or more must become members of the Federal Reserve system by 1941 in order to retain membership in the system of federal deposit insurance. If the country is not ready to take action on the more fundamental questions of commercial banking, such as branch banking, and the unification of the banking system, that is not a valid warrant for delaying improvements of the Federal Reserve system, in so far as such changes are clearly desirable in the light of experience and will accommodate themselves to future improvements of our banking structure.

There is, however, a danger of misinterpretation. There has probably long existed in the public mind a serious misapprehension with respect to the Reserve system. The Reserve Act of 1913 was a measure of, after all, limited scope. It did not undertake to modify our commercial banking structure but to superimpose a certain type of regional banking organization upon the already existing commercial banking structure. Nevertheless, many of our people undoubtedly regarded the Reserve Act of 1913 as a complete and final answer to our banking troubles. In their view, it was to mark the end of banking crises and bank failures in this country. That twenty years after the passage of the Act we should have the worst banking crisis in our history has, therefore, led many people to lay at the doors of the Federal Reserve system the responsibility for defects which, in considerable measure at least, were inherent in our commercial banking structure. There is now some danger that this misinterpretation may be repeated in connection with the new banking Act. It cannot, therefore, too often be repeated that this bill is not and cannot be a substitute for, or a corrective of, the fundamental defects of our commercial banking structure and practice.

RECENT LEGISLATION AND THE BANKING SITUATION

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My purpose in this paper is to appraise the banking legislation of the last three years, and especially the Banking Act of 1935, from the point of view of the adequacy of the remedies which it provides for the structural and procedural defects in our banking system as revealed by the sad events of the past five years. I wish to make it clear that I do not profess to be a banking expert, and that the views I express are presented as those of a layman, and are purely personal. To economize the use of the time allotted to me I will take it for granted that my audience is acquainted with the general lines of the banking legislation of the past few years. Furthermore, I will regard questions relating directly to the nature of our monetary standard as outside the scope of my paper. But since banking policy cannot be intelligently discussed in terms of a monetary vacuum, I will assume that our currency will in the future continue to be anchored either to an international monetary metal—one metal—or, by exchange pegging, to the currencies of at least an important section of the outside world.

An outstanding aspect of the depression in the United States was the extraordinary weakness which the American banking system revealed under pressure. The mass withdrawals of cash by the banks, the forced liquidation of their assets by the banks in their desperate attempts to remain open, the repeated waves of banking failures which were survived only by those banks which were most quick and most expert in converting themselves into safety deposit institutions, the final closing of the system as a whole, these phenomena were without a near parallel in any other country, although this was a depression which no western country escaped. The depression, it is true, was more severe in the United States than in most other countries, but the weakness of the banks must be held largely responsible for this. In any case, after the most generous allowances have been made for this and other extenuating circumstances, our banking record was deplorably bad. While other countries also suffered from flights away from their currency, we alone had to endure flights from the banks to the currency while the currency itself was still free from pressure. As a result of this loss of confidence by the public in the banks, and by the banks in each other, the deflation of bank credit was carried much further in the United States than in almost any other country for which comparable data are available. Measured by total bank loans and investments, the volume of bank credit was in the low year of the depression only 62 per cent of the 1929 level in the United States, as compared to corresponding lows of 97 per cent in England, 82 per cent in Canada, and approximately 80 per cent as the average for thirty-eight countries.

What are the causes of this peculiar weakness of the American banking system? The explanation, I am convinced, lies in the fact that of all the modern national banking systems it alone has adhered predominantly to the eighteenth-century model of individual small-scale units, as distinguished from large-scale banking institutions with many branches. The American bank-closings of 1931 to 1933 were but a typical reproduction of the normal events of an English business depression before the development in England of branch banking on a large scale.

The unit-banking system has deep roots in our history, in our regional diversities, and local loyalties. Its persistence is due to the support it derives from state jealousy of encroachments on state autonomy, from agrarian and small-town jealousy of the metropolitan areas, and from the nation-wide fear of undue concentration of financial power in the great metropolitan centers, and especially from fear of Wall Street domination. The legislation of the past few years has failed to clear the legal barriers from the path to large-scale interstate branch banking. However glaringly parish-pump banking may fall short of meeting the banking needs of an economy which is in other respects national and even international in the scope of its operations, a better system could be substituted for it only at the cost of a major political battle in which there would be ranged against the reform not only the small bankers themselves but also the agrarians, the small-town people, the state officials, the many persons who feel that many of our economic woes come from the bigness of our economic units and who cannot see that an exception should be made for banking. The present Administration, so far at least, has shown no eagerness to wage this battle, in which it would find its friends on most other issues ranged against it and its foes not to be trusted to surrender the opportunity to make political capital even on an issue on which the Administration happened to be on the right side. It may be regrettable, therefore, but it is not surprising, that the Administration has not undertaken to eliminate this serious flaw in our banking structure, but has instead, in the words of Governor Eccles, decided that "we cannot go faster than the people of the country are willing to have us go."

I would perhaps be less disposed to find excuses for the failure of the Administration to establish an open path to interstate branch banking if I did not share many of the loyalties and prejudices whose hold on the American public affords to the small unit-banker a politically powerful defense against his exposure to the competition of branch-banking giants. The literature in support of branch banking, moreover, seems to me often to overestimate its advantages or to look for them in the wrong directions and to dispose too cavalierly of the objections which have been raised against it. Even the economies of branch banking, of which so much has been made in the literature, seem to me to be highly conjectural. In Canadian experience the potential economies have been largely dissipated in expensive premises,

in undue multiplication of branches, and in other types of promotion and advertising expenses. This is indeed the result to be expected a priori from the reduction of the number of competitors in any industry in which it is not good form competitively to reduce the charges to the public for services but in which it continues to be good form to win away clients from rival concerns by cost-raising as distinguished from price-reducing activities. But for the national economy, if not for the individual customer of the bank or for the banker himself, branch banking has certain indisputable advantages which seem to me, and apparently to all economists who have lived in a branch-banking country, to be overwhelmingly more important than all the disadvantages which can conceivably be charged against it. It automatically provides diversification of risks, regional and occupational, for each independent unit in the banking structure. By reducing the number of independent units and increasing the importance of each unit, it imposes on each bank a measure of recognition of its responsibility for the impact on the national economy of its own activities and of recognition of its obligations to the rest of the banking system. The large units which result from branch banking can afford to attract a higher grade of talent and to subject their personnel to a superior and broader economic training than can the average unit bank in the United States. In reducing the number of responsible executives, branch banking also facilitates the achievement of co-operative action in emergency situations whether on the initiative of the bankers themselves or in response to governmental pressure. The size of the units gives to them a prestige and an appearance of strength which, whether it is justified or not by the facts, is extremely valuable in a crisis. These are extremely important advantages of branch banking, especially during a severe depression, but it appears that it will take at least one more severe depression before we learn that we cannot do without it.

This country, unique in clinging to unit banking, has developed two methods of minimizing its shortcomings which are also largely peculiar to itself; namely, detailed bank regulation and supervision and public guarantee of bank deposits. There are in this country forty-eight state authorities with power to supervise, examine, and regulate state banks, each with a headquarters and a field staff. There are four federal authorities independent of each other with powers of supervision and regulation which overlap both as between the federal agencies themselves and as between the federal and the state agencies. There is no detail in the operations of any American state or national bank which is not subject to statutory or administrative scrutiny and regulation, and in practice the regulation and the examination are carried out to the most minute details. There is no other American industrial or commercial activity—outside of the prison workshops and the issue of coin and currency—which is as rigorously regulated and as closely supervised. Nor can any parallel be found in the banking field itself in

other countries. Unless I am mistaken, except for the restriction on the issue of its own paper money, an English commercial bank is subject to no restriction which is not a part of the body of commercial law to which all persons and corporations are subject, is required to make report to no official agency except the income tax collector, and receives no visitations from any government official. In Canada, where in spite of the predominance of branch banking they still had bank failures before the War, perhaps through contagion from across the frontier, the chartered banks were in 1913 subjected to supervision and examination, but to date the entire supervisory and examining staff appears to consist of an inspector-general and an army of two or three clerks and stenographers.

It is evident, therefore, that bank supervision and examination are neither necessary nor sufficient conditions to assure that the banking system will be strong enough to withstand a severe depression without wholesale collapse, although it may be presumed that the record of the American banking system would have been even worse if it had been wholly free from supervision and regulation. But unless it is directed with this danger in mind, the nature of the examining process is itself such as to impose upon the activities of the banks a perverse cyclical pattern from the point of view of stabilization. The examiners, through the qualitative credit standards which they impose on banks, indirectly influence the quantity of bank credit. When business is prosperous and optimism prevails, examiners, like the bankers themselves, must tend to appraise credit risks in terms of the favorable conditions of the moment. The bankers, and especially the small bankers, confident that what is good enough to pass the scrutiny of the examiners should be good enough to meet their own standards, persist on their career of credit expansion. Later, when the tide of business turns, when banks begin to fail and loans which were passed without criticism during the boom days have to be written off as bad debts, the examiners are blamed. Reacting in a perfectly natural manner, they become stricter and more exacting in the standards they apply, and they press the banks to liquidate loans and investments which the banks, if left to their own devices, would be happy to keep in their portfolios. The process of bank examination thus tends to encourage credit expansion during the upswing of the business cycle and, more seriously, to intensify credit contraction during the downswing.

There is an obvious cure for this perverse effect of bank examination, requiring three innovations in the administration of the examinations: unified control of bank supervision and examination; co-ordination of examination policy with credit control policy; and systematic and continuous supervision and instruction of the examiners in terms of a uniform and flexible policy. Fully to attain all of these objectives would require the centralization of all bank examining functions under the direction of the Federal Reserve Board. Some progress toward centralization of examinations has been made in the

last few years as the result of the examining authority acquired by the FDIC over insured non-member state banks. Important progress toward co-ordination of examining policy has also been made administratively, through gentlemen's agreements between the examining authorities. It is still possible, however, for the Comptroller of the Currency, the FDIC, the RFC, and the forty-eight state examining authorities to neutralize through their influence on the individual banks the efforts of the Federal Reserve Board, as the central credit control agency, to secure a loosening or a tightening of bank credit. For a time during 1933-34, while the President, the Secretary of the Treasury, and other federal officials, were urging the banks to relax their credit standards from their deep depression severity, various of the examining agencies were exercising pressure on the banks to purge their portfolios of assets classed "doubtful" and "slow," "slow" being a technical examining term as to whose meaning no two examiners can be found to agree except that it does not mean slow. Full unification of the administration of examinations must wait upon full unification of the banking system as a whole, but the recent banking legislation has failed to bring about statutory improvement in even the federal situation, a failure for which there is not the excuse that it faced serious political obstacles, for the only obstacles in the way were the minor rivalries of the several examining authorities, who perhaps did not all love each other as much as good Democrats should.

Of all the possible sources of credit deflation during the depression, the most formidable, when it occurs, is a mass movement of depositors to convert their bank deposits into legal tender money or into gold. The establishment of federal guarantee of deposits should provide a substantial safeguard against the recurrence of this phenomenon in the future. It is often claimed that deposit insurance operates to weaken rather than to strengthen the resistance of a banking system to severe strains, because it removes the incentive to depositors to select strong banks and thus promote their growth at the expense of the weak ones, or because it lessens the appeal to depositors of sober and efficient management and ample capital resources, and thus weakens a needed disciplinary influence on the bankers themselves. These arguments against deposit insurance are logically sound, but, except as the present deposit insurance legislation discriminates against the large bank, I do not see how they can have much significance in relation to the existing insurance scheme. Under the existing legislation, individual deposits are guaranteed only up to $5,000. It is predominantly, therefore, the small depositor who receives protection. Now the common run of small depositors has neither the information necessary to appraise the status of a bank nor the competence to interpret the information if it was available to him. Runs seem to fall into three categories: irrational "panic" runs on individual banks, based on rumors having little or no relation to the actual

status of the bank, in which runs small depositors are likely to be the initial and the predominant participants; runs on individual banks, having justification in the condition of the bank, in which runs large depositors and insiders are likely to be the initial and the predominant participants; and mass depression runs, resulting from widespread loss of confidence in the status of the banks as a whole. It is only withdrawals of deposits of the second class which can be regarded as applying a useful discipline to the banking system as a whole; and in runs based on information, the depositors insured under the present legislation would ordinarily play a minor rôle. In depriving at least small depositors of any motive to participate in panic or depression runs, deposit insurance should be expected substantially to lessen the danger of such runs, and thus increase the ability of the banking system as a whole to meet a depression without engaging in drastic liquidation to ensure liquidity.

Incidental to the deposit guarantee scheme, moreover, are provisions which give to the FDIC potentially important powers of supervision over insured banks, including banks not otherwise subject to federal regulation, and even more important if exercised, powers over the admission of new banks into the insurance scheme, thus enabling it to some extent to prevent the establishment of new weaklings or of new banks which, by their competition, would endanger the solidity of existing banks in their locality. The 30,000 banks of 1929 have now been reduced to some 15,000. This seems to me a sufficient number of banks to provide ample banking facilities for the nation. The rest of the world manages to get along with less.

The FDIC legislation was drafted with the most painstaking care and, I believe, with great skill, and it may have been as good as was at the time obtainable. Some obvious defects, however, call for the most serious consideration. The premium of 1/12 of 1 per cent on deposits is, on past experience, almost certain to prove insufficient to meet the drafts on the insurance fund, even in the absence of recurrence of major depressions. Those who foresee the accumulation of a fund so large as to constitute in itself a significant problem for credit control are finding bogeys where they may. As bank earnings grow, it seems to me it will be a wise precaution to increase this premium, especially until time has tested whether the wholesale elimination of weak banks during the depression and the added regulatory and supervisory powers of federal agencies will suffice to lower the pre-depression loss ratio through failures.

Under the deposit insurance legislation the premium is levied at a uniform rate on all deposits although only deposits up to $5,000 are protected. This apparent injustice has been defended on the grounds that it is mainly the large banks who hold the large deposits, that large banks, as members of a common banking system, gain from the increased stability of the smaller banks resulting from the insurance, and that since it is mainly the large

banks which have profited from the prohibition of interest payments on demand deposits they are compensated by this provision for the burdens imposed upon them by the insurance scheme.

I find myself unable to follow this reasoning. The large banks gain from the increased stability of the small banks, but so do at least equally the small banks gain from each other's increased stability, and from the greater stability of the large banks, and if this reasoning were carried out to its logical conclusion each bank should pay the premiums not on its own deposits but on the deposits of other banks. There is, moreover, no obvious connection between payment of interest on demand deposits and deposit insurance. Payment of interest on demand deposits has never been compulsory, and the legal prohibition on such payment merely hastened and intensified a process in which the banks were voluntarily engaged under the pressure of meager earnings on the use of these deposits. The real basis for the charge of premiums on uninsured deposits is to be found in the fact that many of the small banks are not paying their way and cannot afford to pay their appropriate share of the insurance cost, so that instead of closing these banks, the large banks are being forced to subsidize them. Its net effect is to weaken the relatively stronger elements in the banking structure in order to keep alive the relatively weaker elements, a type of compulsory benevolence which if continued indefinitely and carried further would provide a sure guarantee that the banking structure will retain its inherent weaknesses and that the deposit insurance scheme will go the way of earlier schemes of this nature.

I come now to the provisions which have aroused most controversy, those relating to the organization and the powers of the central credit control agency. By the public, and especially by the banking public, they have been criticized, and particularly in the form in which they had progressed through the legislative process up to the point where they encountered Senator Glass, as going too far. By economists they have been critized as not going far enough (far enough, for some of them, apparently involving a major reconstruction of the banking system, and adoption of some simple statutory rule of credit control, requiring, generally, a complete breach of all entanglements with the gold standard or with foreign currencies). On the latter criticism the history of these provisions has some bearing. The plan of the Administration originally called for no fundamental banking legislation in 1935 except the replacement of the temporary deposit insurance scheme by a more permanent one. The provisions in Title II of the Act of 1935, as they appeared in the original bill, were therefore somewhat of an afterthought, and do not, I hope, by any means represent the full extent of the banking reforms which the present Administration is prepared to support. But aside from the questions connected with unit banking and its inherent weaknesses to which I have already referred, it seems to me that, with

that as far as practicable there should be centralization of these powers in

minor exceptions, the legislation in Title II as enacted into law is not only good legislation in substance and form, but goes as far as it was wise to go in the present state of public opinion, of our monetary standard interregnum, and of imperfect knowledge and experience as to the most expedient objectives and methods of credit control.

Title II contains provisions relocating credit control power and provisions strengthening and extending credit control power, but does not expressly place any new mandate upon any authority or change the objectives to be pursued through the exercise of such authority. In so far, therefore, as Title II results in any changes, for better or for worse, in the operation of credit control, it will be because of changes in the personnel with whom the power of control rests or because of the increase in the powers legally entrusted to them, but not because of any change in legislative objectives. The issues involved in the location of power were probably not nearly as important as the heat of the discussion would indicate, and the heat was probably generated more by anticipations of the purposes for which the power would be exercised according as it was given one location or the other, than by an aesthetic interest in the niceties of administrative organization. As long as objectives were not clearly laid down by statute or crystallized in a powerful tradition, it was inevitable that different views as to appropriate policy would reflect themselves in a struggle for the location of power in those quarters where such views would be most likely to dominate. From the point of view simply of efficient administration of credit control policy, whatever that policy might be, reorganization was obviously necessary. It was urgent that there be one central agency in which responsibility rested for credit policy, and in which was vested all the important control powers so that they could be exercised in a harmonious and co-ordinated fashion, and the existing situation fell far short of this. Control over rediscount rates was divided between the Federal Reserve banks and the Federal Reserve Board, with notorious instances in the past of conflict between the banks and of deadlock between the banks and the Board. Control over open-market operations was divided between 14 agencies, consisting of 128 members, each agency with at least a partial veto power over action. Control over reserve requirements was shared by the President and the Federal Reserve Board. Without taking into account the diffusion of authority over security margins, purchase of acceptances, and bank examinations, and in connection with the provisions of the Thomas amendment of 1933, and the direct credit control powers of the Treasury, to say nothing of a host of other minor provisions which have direct bearing on the volume of bank credit, it should be apparent that so fantastic an exhibit of administrative disorder could never have been deliberately designed by man, but must have been the product of a long process of patchwork legislation for which control of the volume of credit was not a major objective. If it was desirable

that as far as practicable there should be centralization of these powers in a single agency, then the logical agency was the Federal Reserve Board. In so far, therefore, as the original Title II provided for such centralization, I believe it was moving in the right direction, but not far enough. The proposals of the original Title II have in this connection survived almost intact, for the provision in the Act as passed that the open-market committee shall include, in addition to the members of the Federal Reserve Board, a minority representation of the regional banks, constitutes a change from the original bill in the size of the committee but not in the nature of its membership. I hope that by a process of further piecemeal legislation the Federal Reserve Board will gradually acquire undivided authority over most of the other instrumentalities of credit control to which I have referred, and that in those cases where the activity cannot appropriately be lodged with the Federal Reserve Board it will on principle be so exercised as to be as neutral as possible in its bearing on the total volume of bank credit.

The method of appointment to the Board, the conditions of tenure, and the tradition which should be established with respect to the status of the Board, should be those appropriate to a public rather than a private agency. A Board whose function it is to change, in the public interest, the pattern of banking and business behavior from what it would be if left to take its own course, cannot appropriately consist of representatives of, or in any way be dominated by, the bankers and business men themselves. It by no means follows, however, that the Board should be a mere administrative agency of the government, holding office at the pleasure of the President, and operating merely or even substantially as an agency for the execution of policies serving the convenience of the Administration of the moment. The relationship of the Board to the government must always be more a question of the relative strength of personalities than of the legal definition of lines of authority, and a complete disassociation of the financial policies of government and the credit policy of the Board is unthinkable. But the harmonization of the activities of the two sets of authorities must be through exchange of views between agencies which meet as equals rather than by making one agency merely the instrumentality of the other. Security of tenure, and freedom from pressure except the pressure of reasoned argument, are essential to the good functioning of the Board, whose obligations are to the nation and to the federal government only as the latter is the most important servant of the nation. If this were understood, I cannot see that the proposal in the original bill that the Governor should hold office as Governor at the pleasure of the President was seriously objectionable, since if he should thereby tend to act merely as the mouthpiece of the Administration he could always be outvoted by the other members of the Board. At the same time I cannot see that the provision in the Act as passed that the Governor should be appointed for a four-year term, or the exclusion

inaction and indecision, the concrete issues which it faced were always complex and involving a conflict of legitimate objectives, instead of being

from ex officio membership in the Board of the Secretary of the Treasury and the Comptroller of the Currency will, in practice, establish a gulf difficult to bridge between the government and the Board. Ample liaison between the President and the Board, and between the Treasury and the Board, can be maintained without difficulty and on a more healthy basis if their contacts are not governed by formal procedures implying the exercise of legal authority rather than of mutual counsel. Against intransigence, error, or partisan opposition, on the part of the Board, the federal executive must be content to rely upon its powers of appointment, on the pressure of public opinion, and on the powers of Congress to force the Board to bend to the government's will. These powers, plus the influence of the President's personality and office, seem to me the only powers which the government can legitimately wield over the credit control agency.

The new Board will enter upon its functions without formal instruction or authorization to control credit beyond the old injunction to conduct its operations with a view to "accommodating commerce and business and with regard to the bearing of its activities upon the general credit situation of the country." This formula is assuredly ambiguous enough to give the Board all the leeway it needs in order to apply its various powers to the objective of stabilizing business. The recent banking legislation has nevertheless been criticized by some economists because it has not laid down in precise and unmistakable terms the objective at which the Board should aim in conducting its control activities and the rules of procedure which it should follow in pursuing that objective. On the other hand, we find many objecting that there is nothing which the Board can do which offers any promise that it will even tend to stabilize business, and that the mere notion that through quantitative credit control the amplitude of the swing of the business cycle can be moderated is absurd in theory and has been disproved in practice. Into this area of controversy I do not venture to enter, but it may be pointed out that while such extremely divergent views can still find strong support within our professional ranks, we still have a long way to go before we can frame with assurance the desirable objectives and limits of credit control and a mechanical procedure to be followed in executing it. In this connection the literature of appraisal of the past record of the Federal Reserve Board is enlightening. The tone of the literature is in general highly critical, especially in recent years, but if the comments of the different writers on specific parts of the record are compared, it becomes apparent that there is an extreme disparity of judgment as to what was right and what was wrong in the particular actions or failures to act of the Board and as to what the proper action would have been when it acted wrongly. It seems clear from the record, also, that while the Board never worked out anything like a consistent philosophy of control and, like central bankers in general, had a predisposition to plead the impotence of central banking as an excuse for

the Treasury permanent control of the volume of credit sufficient to offset

inaction and indecision, the concrete issues which it faced were always complex and involving a conflict of legitimate objectives, instead of being reducible to the statistically definable objective and the arithmetically definable procedure for attaining it which figure so prominently in much of the recent academic literature on credit control policy.

Since, therefore, the economists cannot yet honestly claim that they can clearly formulate what ought to be the definite objective of credit control and what procedure, used in what measure, can bring us as near to that objective as is possible, and since even if they could make such claim there is no evidence that they could convince Congress of its superiority to the even more confident claims of the Cutting bill, or the silverites, or the Townsendites, or the Coughlinites, it seems to me a matter for rejoicing that the Board has been left free to develop, by analysis and experience, an adequate philosophy of control. Of one thing I feel sure, that if they approach a solution, its merit will be proportional to its complexity rather than its simplicity.

There are other reasons why it is fortunate that there has not been imposed on the Board a definite mandate to stabilize in a specified sense and by a specified procedure. For some time to come the new Board will have to adjust its activities to the activities of another federal agency equipped for the time being with credit control powers of co-ordinate extent with its own, and pursuing objectives which are avowedly extemporized from day to day as the internal and the international situation undergoes change. By transfer of its cash balances from member banks to Federal Reserve banks, by issue of silver certificates to purchase American silver or to represent the seigniorage thereon, and by its gold purchases and sales the Treasury can in effect, though not necessarily in intent, carry on operations equivalent to the open-market operations of the Federal Reserve system. By changing the proportions in which it finances its expenditures by taxes or by loans and by changing the proportions in which it finances its deficits by bills, notes, or long-term bonds, the government is affecting the volume of bank deposits and the velocity with which they are used, and is indirectly affecting the amount of excess reserves. In the dim background, moreover, is the Stabilization Fund, whose operations are shrouded in a veil of secrecy which only our most imaginative financial journalists have succeeded in penetrating, and in the even dimmer future there must be definitely decided to what type of monetary standard our credit control policy must adapt itself. Finally, there is that pension fund of astronomical proportions for which statutory provision has been made. Those who cannot be persuaded that legal verbiage sometimes serves as a vehicle for pipe-dreams as well as to state—or conceal—the law, and who therefore accept the statute at its face value as assurance that such a fund will actually be accumulated, must reconcile themselves to the fact that the management of a fund of such dimensions would give to

maintains a genuine excess of the value of its assets over its liabilities, and

the Treasury permanent control of the volume of credit sufficient to offset any operations of the Federal Reserve Board, even if its present powers and resources were exercised to their maximum possible limits.

Whatever, therefore, may be the validity of the argument that in normal times the credit control agency should be empowered to act only in accordance with a policy specifically laid down in the law and by procedures prescribed in detail in the law, under the conditions now prevailing legislation along such lines was clearly impracticable. The new Board, equipped not only with new powers but also with a new name, and thus let us hope conditioned against slavish imitation of its predecessor's mistakes, will be free to use its discretion as to when and how and in what measure to act. Upon the quality of the appointments to the Board, and upon the adequacy for their tasks of the research and operating staffs which the Board builds up, will depend more than upon any other factors the success or failure of the recent banking legislation.

The new powers of the Board include both increased powers of credit expansion and increased powers of credit restriction. The former are not likely to receive much exercise until the next depression comes, but they may then serve to prevent a recurrence of the disastrous credit contraction of the present depression. The chief changes of the expansion—or rather antideflation—type are liberalizations of the limitations on the types of securities which the Federal Reserve bank may accept as a basis for rediscounts; so that member banks, as long as they are solvent and can provide collateral, will not be estopped from obtaining needed help from the Federal Reserve banks merely because of a shortage of assets of certain narrowly-restricted types. To the school which holds that if commercial banks limited their portfolios to short-term commercial paper, credit booms and crises could not occur and the volume of bank credit would always be proportioned to the "needs of business," these liberalizing provisions are presumably anathema. But that school is nursing ancient fallacies. In a banking system whose portfolio consisted only of "sound" short-term commercial paper there still would be ample scope for drastic cyclical fluctuation: in the velocity of use of bank deposits; in the monetary volume of commercial discounts resulting from fluctuations in the price level and in the number of hands through which commodities passed before reaching the consumer; in the ratio of commercial transactions financed by recourse to the banks to the total volume of commercial transactions; and in the total physical volume of business. This school is right in its contention that within substantial limits a banking system can during a depression liquidate its assets, but it is wrong if it regards such liquidation as an activity to be welcomed and fostered while the central bank still holds adequate reserves.

In a properly organized banking system every bank should feel that its liquidity is assured through the rediscountability of its assets as long as it

maintains a genuine excess of the value of its assets over its liabilities, and liquidation or expansion of the system as a whole should be controlled by the central bank and not by the wishes or the exigencies of the individual banks. The extension of the rediscount powers of the Federal Reserve banks marks an important step in this direction, and it is within the power—and the responsibility—of the Federal Reserve Board that it shall not be so used as to foster credit expansion at inappropriate times or to inappropriate degrees.

To the powers already possessed by the Federal Reserve system of contracting the volume of bank credit there has been added by the legislation of 1933 and 1935 the power to vary the member bank reserve requirements within the limits of the present rates and double the present rates, a novel power, not possessed by any other central bank. This power will probably prove useful not only, as contemplated by its advocates, to reinforce open-market operations, but also as a substitute for open-market operations. Open-market sales impinge directly on one borrower, the Treasury, and occasions may well occur when credit contraction is indicated but when the Treasury has important bond maturities impending. On such occasions the Treasury might—and with some justification—vigorously object to being made the scapegoat for the financial excesses of the community, but could not legitimately oppose an increase in member-bank reserve requirements which distributes the burden of the retrenchment thinly over the entire community.

There is at least one additional restrictive power which I believe it would be desirable to provide by legislation; namely, power of the Federal Reserve banks to borrow from the market. It is conceivable that a situation might arise: where the banks were not indebted to the Federal Reserve banks, so that the rediscount rate was ineffective; where open-market sales would be peculiarly embarrassing to the Treasury because of impending bond maturities or to the Federal Reserve banks themselves because of the realization of capital losses they would involve, or where the system had already disposed of its Governments; where the member bank reserve requirements had already been raised to their legal maximum, or where because of regional or other considerations, it was regarded as inexpedient to raise them; but where restrictive action of some sort nevertheless seemed urgent. Under such improbable but not inconceivable circumstances, short-term borrowing from the market by the Federal Reserve banks would be an appropriate measure. It is a credit control device with ultra-respectable antecedents, for the Bank of England used it systematically in the eighteenth century, and has used it intermittently since. It may be, however, that the lawyers would hold that its use requires no new legislation, and that its employment would be possible under the general corporate powers of the Federal Reserve banks.

The need for any additional powers of control over the volume of credit is, however, assuredly not urgent. The instrumentalities already available to the Federal Reserve authorities and other federal agencies for checking a credit expansion or enforcing a contraction are much more extensive in range than is generally realized. That they are sufficient if exercised to stop any inflationary boom in its tracks seems to me not to be open to reasonable question, and if a dangerous expansion should come it will be because the authorities concerned prove lacking in the will or the courage to exercise them.

DISCUSSION

E. A. Goldenweiser: As a humble public servant, I feel very hesitant about making comments on papers by stars in the academic firmament. I feel that the American Economic Association is to be congratulated on the admirable discussion of the Banking Act of 1935—a discussion which in its competency and accuracy contrasts sharply with most of the discussion that has been had on this legislation.

I want particularly to express my agreement with two points made by the speakers: one, that the administration of law and the policies actually pursued by the authorities are more important than the particular details of machinery that is prescribed in the law; and, secondly, that the underlying commercial banking structure is greatly in need of reform and that without such reform, and particularly without unification of banking supervision, the Federal Reserve banks will remain under a severe handicap in regulating credit conditions.

I have a feeling that Professor Viner may have fallen to some extent into the error against which Professor Williams warned; namely, of ascribing too much power to the Federal Reserve system in smoothing business fluctuations. I think that we have good machinery, still to be tested, for the control of expansion, but I doubt whether we have yet devised adequate means for combating a deflation. So far the only method for overcoming deflation that has been discovered is to prevent the preceding inflation.

In connection with Professor Williams' paper, I want to raise a question about his comments on the composition of the Open Market Committee. I agree with Professor Williams that all the instruments of credit control, including discount rates, open-market operations, changes in reserve requirements, changes in margin requirements, and changes in interest rates on deposits, should be concentrated in one authority. But if all these powers are to be concentrated in one authority, the question arises whether a committee consisting of seven members of the Board and five representatives of the banks is the best authority to which to entrust all these powers. It will be remembered that President Wilson refused banker participation on the Federal Reserve Board and that the principle that banking control should not be in the hands of bankers is a well-established principle. And yet the proposal would place all the important policy powers in the hands of a committee of which five members are representatives of the banks. I realize, of course, that the governors of the Reserve banks are not direct representatives of member banks, but nevertheless they are elected by boards of directors, two-thirds of whom are elected by member banks. This raises an important question of policy.

I also have a question in mind whether it is proper to entrust all the important policy matters to a committee which only meets periodically. It seems to me that in order to discharge its functions adequately the body that has the responsibility for credit policy should be in continuous session, giving its entire time to such problems. This question will have to be settled some day. In the meantime, it may be that as a practical matter of operation it will work out satisfactorily under the existing law. If it does not, then the law will ultimately be modified.

In connection with remarks by Mr. Hardy, I should like to raise a question about his interpretation of raising reserve requirements as a means of keeping

the gold in this country. It would seem to me that exactly the opposite is the case. If the gold were not permitted to become incorporated into our reserve base, if it were sterilized by an increase in reserve requirements, it might be much easier to let it leave the country without starting a deflationary movement here. If Mr. Hardy has in mind that gold by having its normal influence in this country might create an expansion that would drive the gold out, his view may have been correct when most of the world was on an automatic gold standard, but is not applicable to conditions as they exist today, with very few countries on the gold standard and with excess reserves in this country at the extraordinary level of $3,000,000,000.

THE ECONOMIC ASPECTS OF AN INTEGRATED SOCIAL SECURITY PROGRAM

SUMNER SLICHTER, *Chairman*

EWAN CLAGUE: In establishing such a comprehensive and far-reaching system for providing security to millions of American individuals and families the nation must face one fundamental, all-important problem; namely, how can we guarantee social security to the individual and at the same time safeguard society by keeping our productive economy functioning reasonably well?

This problem has not received sufficient attention in the development of the present security program. The inducements to or pressures on the individual, as expressed in the various forms and conditions of participation in the program, are not well adjusted to the incentives of people whether they are at work or in need.

In the first place, an unsatisfactory relationship exists between old age annuities, which are contributory, and old age assistance based on need. A wage earner who contributes toward an old age annuity for forty years may receive in the end an annuity of approximately $40 per month, with which he might have to support a wife. But another man who has never contributed, because he has been employed throughout his life in the various exempted occupations, would be eligible for old age assistance on a charitable basis at a rate of $30 per month plus $15-$30 additional for his wife. Thus a public assistance family might actually be better off than an annuitant's family.

In the early stages of development, when low annuity payments will be made, this difference will be accentuated. For ten years or more after 1942, there will be millions of annuitants retiring with pensions of $10 to $30 per month; many of these will have to apply for old age assistance to supplement the annuity. This anomalous situation should certainly be changed.

In the second place, there is in the old age annuity plan itself an undue amount of "leveling"—first, in favor of older workers with five, ten, or fifteen years of service and against younger workers who will pay for twenty, thirty, or forty years; second, in favor of low-wage workers and against high-wage workers (but only up to $3,000 per year). The effect of these two provisions is to penalize unduly a particular class of wage earners—those with incomes centering around $3,000.

In the third place, there is a total lack of integration between the various "categories" of relief provided by direct public assistance. The aged, for example, can get $30 per month per person, with the federal government contributing half the money. Widows with children, however, would get only $30 per month for three persons, and of that only one-third would be contributed by the federal government. Furthermore, a state could accept one of these without the other; so one class might be denied assistance altogether. Last of all, sickness—which looms extremely large in the average family's budget—is not covered at all.

Fourth, it seems to me that there has been entirely too much emphasis on the so-called "demoralization" of the dole and the saving grace of work. If, as in

many New England communities, the family on relief must plead pauperism, be denied voting rights, and have their names posted on public bulletin boards, then certainly it is demoralizing. But if relief is given in a self-respecting manner by intelligent administrators many of the worst effects of the dole can be at least partially avoided. On the other hand, I question very much indeed the "morale" value of "made" work, or of placing a skilled workman (carpenter) on an unskilled job.

We must be very cautious in rushing to the conclusion that the first thing we must do for an unemployed man is to push him into a job, any job, as quickly as possible. There is one fundamental virtue in direct relief and in its prototype, unemployment insurance; namely, that they both tend to keep a wage earner in his established occupation through an extended period of idleness. This is not waste; this is good economics and good engineering in the long run.

Finally, all these points can be summed up in one basic problem; namely, that of adjusting our relief security system to our producing economic system. Instead of a sharp break, there must be a reasonable gradation from the one to the other so that margins can be maintained, that individual incentives can be balanced against social pressures, and that justice shall be done between different classes and individuals. We must not lose sight of the fact that the productive system provides the means for obtaining social security, and that security is limited to that level which our system will furnish.

[The next speaker was Eveline M. Burns. Since her paper is to appear in the *American Economic Review*, no summary appears here.—EDITOR]

J. DOUGLAS BROWN: An intelligent handling of the reserves involved in the new federal social security program requires that the maximum reserve be small enough to be readily handled within the normal federal debt structure. There must be liberal allowance for all other uses of federal debt, such as investment by banks, insurance companies, and other purchasers of federal securities.

The high reserves involved in the old age provisions of the Social Security Act were not inherent in the program as originally developed. They were the outcome of the changed schedule of taxes inserted at the request of the Secretary of the Treasury. There is little likelihood that such high reserves will ever be accumulated. A return to the lower maximum tax rates and a more gradual step-up, as originally proposed, seems inevitable to avoid serious dangers.

Smaller old-age reserves could be readily handled without causing undue disturbance to the fiscal policy of government. Such handling would involve, during a period of net accumulation, the substitution of debts arising through the sale of federal securities to the reserve for debts already outstanding or otherwise arising through the sale of new securities to the public. When partial liquidation of the reserve becomes necessary, the reverse process would occur. Operating on this basis the reserve would be essentially a subsidiary system of governmental bookkeeping permitting transfers of credits without continuous legislative direction.

On the other hand, the accumulation of a large, old-age reserve, exceeding in amount the normal federal debt, might seriously warp federal fiscal policy in en-

couraging either unwarranted spending or the reduction of general taxes. Fiscal policy would be adjusted to the reserve, and not the reserve operations to the fiscal policy. The withdrawal of large amounts of federal securities from the general investment market for reserve purposes might be most disturbing.

While a "pay-as-you-go" plan of financing federal old-age benefits on first thought appears attractive, the most workable program seems that of a relatively small, contingency reserve—gradually reaching perhaps ten billion at its maximum many years hence—supplemented in later years by federal appropriations. The use of federal securities in a reserve merely renders the diversion of funds more automatic—permits accumulation of "authorities" to disburse without new tax legislation and without the necessity of a new credit expansion authorized by the legislative branch. Thus the contractual aspect of the scheme is enhanced. Definite benefits can be planned for and the great advantage of lifting the scheme out of variable relief becomes possible.

William Haber: An integrated program for social security can choose between three basic types of assistance: social insurance, direct relief, and emergency public employment or work relief. Self-sustaining social insurance cannot apply to persons now unable to work, necessarily excludes some occupations, cannot provide for types of unemployment of long duration, or meet the problems of "stranded areas."

Direct relief is the only possibility for those unable to work. But much state legislation needs amendment to unify welfare activities, to embody state-wide standards of relief, to centralize administrative control, provide cash relief wherever feasible, and administration by social workers on a nonpolitical basis.

The need for unemployment relief to workers ineligible for contractual benefits (especially the older workers and those in stranded areas) will be the most vital problem of an integrated security system. Where their unemployment is temporary (as in the case of workers excluded from insurance benefits because of membership in excluded trades or temporary exhaustion of benefit rights) some form of direct relief may be satisfactory.

The long-period unemployed should not be dependent indefinitely on a direct dole. Work relief undoubtedly maintains the worker in better physical condition than complete idleness. It is doubtful whether it makes him more anxious to find a private job, though it helps to maintain the psychological habit of rendering service in return for income received. Some of the projects have been at such a low level of efficiency as to have a demoralizing effect.

Maintenance in idleness is not security for the worker cut off indefinitely from private employment. Work relief may be a useful supplement to the means test as a method of determining eligibility. The value of the completed product can justify a larger income to the work relief employee than could be paid by way of a dole.

Work relief has real advantages in stranded area situations, especially when based on a definite regional plan. Emphasis must be placed on work which is simple and easily learned, and which falls outside the limits of normal government functions. While these conditions suggest a relatively limited work program, such a program may serve as an entering wedge by which government accepts

responsibility for new social services. We must think increasingly in terms of a national program rather than temporary local expedients.

SUMNER H. SLICHTER: Caution should be exercised in incorporating additional contributions from the general budget of the government into the social security scheme at this stage of its development, because the real magnitude of the burden which the government is assuming is not known. Certain it is that the existing scheme represents far greater commitments of taxpayers' money than the letter of the law indicates. The scales of unemployment benefits and of pensions under the scheme are bound to affect standards of relief expenditures by the government on behalf of persons who fall outside the schemes or who have exhausted their right of benefit. Furthermore, the availability of relief on a more liberal scale is likely to influence the number of dismissals by employers. The danger of a burden on the budget that will prove difficult to control is particularly great in the United States where political devices for protecting the spending power against abuses by special groups are almost completely lacking.

With respect to two alternative ways of financing unemployment benefit payments during depressions—the accumulation of uninvested reserves or borrowing during the depression—circumstances seem to make the method of accumulation preferable as far as the immediate future is concerned. Huge government deficits during the last six years have resulted in a spectacular expansion of demand deposits. When these deposits begin to turn over rapidly, an unhealthy boom will develop. The method of accumulating reserves could be used to sterilize some of the dollars created by deficit financing during the depression. The present law might be administered to produce this effect.

CAPITAL FORMATION

Alvin Johnson, *Chairman*

Harold G. Moulton presented the thesis that capital formation cannot, as in classical economics, be attributed simply and directly to saving:

The very process of saving money for investment works directly against the profitable employment of the money thus saved. A decline of consumptive demand and falling prices for consumer goods serve to lessen the immediate possibilities of profit from the use of additional capital goods. It increases the volume of the existing capital equipment that is unutilized and discourages additional construction. . . .

The real demand for capital goods is derived from the demand for its products, and this emanates from consumers. Hence restriction of consumption in order to save money lessens, immediately speaking, the demand for capital goods which is derived from consumption. Expanding output of consumption goods and expanding construction of new capital goods occur simultaneously and not alternately. . . . Expanding consumption and rapid capital formation, and contracting consumption and decreasing capital construction, occur together. There is no evidence to support the view that new capital construction will take place long in advance of consumption.

A simultaneous increase in the flow of money income through consumption and investment channels is made possible by an expansion in the total volume of money and credit, principally the latter. . . . This expansion of credit finds its way into the money income stream through its disbursement in the form of wages, interest, etc. Now this augmenting volume of income makes its possible for individuals both to save more and to spend more than was the case in the preceding time period. Accordingly, the expanding demand through competitive channels does not have to be matched by a contraction in the flow through savings channels, or vice versa. . . . In a period of recovery an expansion of credit for the purpose of financing an increase in the volume of business need not raise prices—the increased volume of credit being matched by the resulting increase in the volume of goods and services. But it is pointed out that the moment the slack in the market for labor and materials has been taken up and capacity production is reached, any further expansions of credit can merely serve to raise the level of prices.

Our studies indicate that in the prosperity period of the twenties, at least, the slack in the market for labor and materials was never absorbed. Indeed, from 1922 to 1929 we had continuously about the same margin of unutilized industrial and labor capacity. . . . The explanation simply is that the construction of new plant equipment was automatically increasing the volume of capital goods, and also automatically increasing the labor supply through the medium of capital displacement. The very term "technological unemployment" implies that the growth of new capital on the upswing of a cycle tends to prevent the development of a shortage either of capital equipment or labor.

We do find, however, that a maladjustment may occur between the rate of increase in saving and the rate of increase in consumptive expenditure. This conclusion applies both to the upswing of the cycle and secular trends. During the prosperity period of the twenties, we find that while both savings and consumptive expenditures were expanding, savings were increasing faster than consumption; in other words, that an increasing percentage of the national income was being diverted into productive channels. This was attributable to the rising standards of living which made it possible for all classes to save more, and also to the fact that the rate of income increase was most rapid in the high income brackets where savings are largest.

In 1929 the money savings of individuals amounted to something like fifteen billion dollars, while the volume of funds that was taken out of the investment markets by business corporations for the purpose of constructing new plant and equipment was something like one-third of this amount. The total volume of corporate issues and farm and urban mortgages floated in 1929 was less than twelve billions. The larger part of the proceeds of corporate issues was not used in constructing new plant and equipment. The amount of actual capital construction that was financed by individual savings in 1929 was in the magnitude of five billion dollars. Business corporations decided how much new capital would be constructed by reference to considerations relating to potential markets rather than by reference to the supply of investment money available.

The truth is that there is seldom any close correspondence between the volume of a nation's money savings and the demand for such savings by business enterprisers. At certain

periods of a nation's history the demand for funds with which to expand plant and equipment may greatly exceed the available supply, while at other times the supply may greatly exceed the demand.

David S. Friday, while accepting generally Moulton's thesis of the simultaneous movements of consumption and capital formation, laid stress upon the expediency of a more general conception of capital, to include durable consumers' goods.

Simon Kuznets also took exception to Moulton's limited conception of capital. The chief point of his criticism was directed against Moulton's thesis of a necessary dilemma, that increased savings mean abundance of funds for capital formation, but the decrease in consumption involved in savings makes the formation of new capital unprofitable:

Let us assume that the volume of consumption declines and the volume of savings increases. This not only reduces the prices of consumption goods, but presumably also the interest rate; i.e., the effective price of capital. Such a decline in the interest rate will possibly create opportunities for capital investment which under the higher rate of interest prior to that time were not in the profitable zone. Thus, whether upon a contraction in the rate of consumption and an increase in the rate of savings there will follow a contraction or expansion of capital formation will depend upon the relative weight of the expansive influence of a lower interest rate and the depressive influence of a smaller rate of consumption. Once capital formation either expands or contracts, it will have a repercussive influence on the volume of consumption, and make for a concurrent movement of consumption and capital formation.

In criticism of Moulton's view that consumption takes the lead in recovery after depression, Kuznets analyzed the relevant statistical material and pointed out that historically there is no ground in principle for assigning a lead to the factor of consumption.

David Coyle stressed the bearing of technological factors upon the problem of capital formation in its relation to prosperity:

The amount of capital formation which will give the best results ought to be examined in the light of the great increase of technical productivity, as compared with the still greater increase in the rate of growth of capital.

For any particular industry, with a specific rate of technological progress, the optimum rate of replacement of plant can be shown to be proportional to the square root of the rate of technical progress divided by the square root of the cost of machinery. A rate of replacement or modernization slower or faster than this optimum will give a smaller net output of useful products per unit of expenditure. This is a physical relationship, independent of strictly commercial aspects. For the national industrial plant as a whole, a similar relation holds.

If capital formation is too slow to provide replacement at the optimum rate, that is a condition which calls for increased savings, voluntary or forced. When the capital formation is so large that replacement occurs faster than the optimum, then the physical standard of living is necessarily reduced.

G. A. Kleene raised the question whether the presence of unused productive capacity might not be ascribed rather to the existence of monopolistic price formation, checking the expansion of consumption, than to the restriction of consumption through saving. He also pointed out that an increase in saving, if attending a relatively greater increase in national income, might be quite compatible with both increasing consumption and capital formation. Again, "saving is not likely to be abstinence from the consumption of necessities." A movement to save at the expense of luxuries would indeed depress the luxury industries, but it would leave open possibilities of profitable investment in the industries

producing necessities. In short, an analysis of the relation between saving and industrial depression cannot be based upon a study of all industry but must look to the specific situation of the several industries and groups of industries. While conceding the importance of expansion of bank credit as a means of expanding both consumption and capital formation, Kleene would not impute to it the cardinal rôle that it plays in Moulton's thesis.

Raymond T. Bye attacked Moulton's thesis at four main points:

> He has dismissed the whole question of interest from the picture—an omission for which no adequate justification is offered, and which is vital for the problem. He has slighted and misunderstood the part played by technological progress in stimulating both consumption and capital formation, yet this was a dominant factor during the very periods on which he lays the most stress. He has confused relative amounts of saving and consumption with absolute amounts. Finally, he has assumed that there are finite limits to human wants. These errors have caused him to misstate the established theories which he criticizes, and they destroy the validity of his own conclusions.

THE TRADE AGREEMENTS PROGRAM AND AMERICAN AGRICULTURE

By Lynn Ramsay Edminster
Agricultural Adjustment Administration

The lack of balance in recent years between agricultural production in the United States and the effective demand at home and abroad for our farm products, and the efforts of the federal government to effect adjustments in supplies calculated to establish a better balance, are matters familiar to us all. Equally familiar is it that reliance upon planned crop reduction has been the subject of not a little criticism from economists and others on the ground that such reduction is predicated upon an economics of scarcity rather than of plenty. Whatever may be the merits of this contention—and surely it will not be denied that the agricultural adjustment program has been one major factor contributing to the great increase in farm income that has occurred during the past three years—there is one thing, at least, upon which all of us ought to be able to agree. We can, I think, agree that any really sound measures that can be taken to revive the demand for farm products at home and abroad will be to the good. If that is a mere platitude, it is nevertheless one which requires stating, if only for the reason that so many critics of the agricultural adjustment program have seemingly wished to "have their cake and eat it" by objecting both to crop curtailment and to the doing of things which it is clearly necessary to do if market outlets for farm surpluses are to be revived and the need for crop curtailment reduced to a minimum.

One of the things that it is necessary to do is to encourage the revival of our foreign trade. To that end, Congress, in June, 1934, enacted the Trade Agreements Act. This Act authorizes the President to enter into trade agreements with foreign countries providing for reciprocal reduction of existing barriers to trade. To that end, the Act authorizes him to reduce the duty on any domestic product included in the agreement by not to exceed 50 per cent of the pre-existing rate. The Act has been in effect about a year and a half. What has it accomplished for American agriculture? Have the results thus far been satisfactory or disappointing? What are the future possibilities?

Up to December 15, 1935, trade agreements had been signed with seven countries; namely, Cuba, Belgium, Haiti, Sweden, Canada, Brazil, and Colombia.[1] Four of these agreements are actually in effect—those

[1] After this paper was prepared two more countries were added to the agreements list—Netherlands and Honduras. The agreement with Netherlands, signed December 20, includes tariff or other concessions (including bindings of existing favorable treatment) by Netherlands on the following agricultural items: lard and oleo oil and stearine (when used for certain purposes); leaf tobacco; apples, pears, grapes, grapefruit; raisins and prunes; canned fruits; canned asparagus; rolled oats; rice; cotton; wheat and wheat flour; soybean cake;

with Cuba, Belgium, Haiti, and Sweden. Two others—those with Canada and Brazil—come into effect on January 1, 1936, though the Canadian is subject to ratification within one year by the Canadian Parliament. The seventh—that with Colombia—now awaits ratification by the Colombian Congress. As of December 15, negotiations were either approaching completion or at a fairly advanced stage with the following countries: Netherlands,[1] Switzerland, France, Spain, Finland, Guatemala, and Honduras.[1] Up to that time negotiations had also been publicly announced with Costa Rica, Salvador, Nicaragua, and Italy but had made little progress in the case of the three Central American countries and virtually none in the case of Italy. With respect to an additional group of countries, data had been assembled to assist in appraising the possibilities of trade negotiations, but no negotiations had been authorized.

Our foreign trade with the seven countries with which we had signed agreements up to December 15, 1935, constituted, in 1934, over 26 per cent of our total foreign trade. The seven countries with which negotiations are fairly well advanced account for an additional 12 per cent; while the four remaining countries among those announced account for about 3 per cent. Thus, our trade with countries with which agreements have been signed or negotiations announced amounted to nearly 42 per cent of our total foreign commerce in 1934. With the seven countries with which agreements have been signed our total trade amounted, in 1929, to over 2½ billions of dollars; in 1934, to less than 1 billion. With the entire group of eighteen countries announced for negotiation (including the seven already concluded) our trade amounted, in 1929, to nearly 4 billions; in 1934, to somewhat over 1½ billions. The decline in quantities has, of course, been smaller. While the limitations of such figures are self-evident, they do serve in a general way to indicate the scope of the program.

Viewing the matter from the standpoint of exports only, it appears that in 1929 our shipments of all goods to the countries which have signed agreements were valued at $1,417,500,000 and in 1934, at $496,300,000; of agricultural products, $228,200,000 in 1929 and $83,946,000 in 1934. Analysis of the agreements indicates, further, that tariff reductions and liberalization of quotas have been obtained on agricultural products which comprised 42 per cent of our agricultural exports to the signing countries

and horsemeat. To Netherlands the United States makes concessions (including bindings) on the following agricultural items: cigar wrapper tobacco; Edam and Gouda cheese; pearl barley; broken rice; flower bulbs; seedlings of rose stock; poppy seed; field and garden seeds of various kinds; split peas; cabbage; sauerkraut; onions (pickled); sisal; kapok; palm oil; sago and sago flour; tapioca, tapioca flour, and cassava. The agreement with Honduras, signed December 18, includes concessions by Honduras on the following agricultural items: hams, shoulders and certain other meats (in containers); rolled oats and other breakfast foods; fresh apples, pears, plums, grapes, cherries, and strawberries; canned and dried fruits; certain canned vegetables; wheat flour; condensed, evaporated, and dried milk. Concessions to Honduras, chiefly bindings on the free list, include pineapples, guavas, mango pastes and pulps, bananas, cocoa beans, coffee.

in 1929. In addition, these countries have bound themselves not to increase during the life of the agreements the pre-existing favorable rates (free or dutiable) on agricultural products which constituted, in 1929, a further 22 per cent of our agricultural exports to them. Moreover, the general provisions in these agreements contain clauses designed to alleviate existing arbitrary trade restrictions of various kinds and to insure against their application in the future. And finally, but not least, they assure to us, through the most-favored-nation clause, the benefits of any concessions extended hereafter to third countries on products in which we may also be interested. In the case of our Cuban agreement, however, the concessions which the two countries extend to each other are exclusive.

The agricultural concessions which we have obtained thus far, including the bindings, cover a wide range of items of both major and minor importance. Including concessions obtained from Canada through her extension to us of most-favored-nation treatment, they cover some 130 items on the basis of United States customs classifications.

The most important group on which concessions have thus far been obtained is fruits and vegetables. This is not because of any disposition on the part of our negotiators to favor these over other agricultural items. It simply happens that the countries negotiated with normally have either year-round or seasonal deficiencies of many of the items in this group, and this has tended considerably to moderate their resistance to our pressure for concessions. A few illustrations will suffice. On grapefruit, Sweden removed its duty; Canada and Belgium cut theirs in half. On oranges we have obtained an extremely valuable concession from the country which takes by far the largest part of our exports; namely, Canada. Canada has placed oranges on the free list for the first four months of the year, when about 40 per cent of our export movement occurs. This is one of the products on which Canada imposed a burdensome duty following our enactment of the Hawley-Smoot Tariff Act. Valuable though this concession is, it is interesting to note that it does not entirely undo the mischief caused by the Hawley-Smoot Act. It still leaves our oranges dutiable during eight months of the year, whereas they were formerly free throughout the year. On fresh apples and pears, concessions in the form either of duty reductions or bindings of free entry have been obtained from all but one of the seven countries signing agreements. To these six, our exports of apples and pears had declined by 1933, in terms of quantity, to about half what they were in 1929. On dried and canned fruits, the story as to concessions is much the same. On fresh vegetables, concessions of capital importance have been obtained from Canada and Cuba. On canned vegetables, concessions—most of them valuable—have been obtained from all but Belgium and Haiti.

Particularly deserving of mention are the concessions obtained from Can-

ada in the way of mitigating the system of arbitrary valuations on imports of fruits and vegetables which she has been employing since our enactment of the Hawley-Smoot Tariff Act. This system has included maintenance of seasonal, minimum specific duties; and maintenance of a particularly onerous system of "advanced valuations," and assessment of antidumping duties on the basis of such advances. By this latter device the ad valorem rate has not only been applied on a valuation higher than the actual sales (invoice) price, but in addition the difference between this arbitrary high value and the invoice value has been charged as a so-called "dumping" duty. The new agreement abolishes the minimum specific duties for all but two items; it cancels the application of the system of advanced valuation in respect of a number of fresh fruits and vegetables; and on the remaining items it guarantees not to fix the valuations in excess of 80 per cent of the lowest advances heretofore fixed. The mitigation of this system of arbitrary valuations is of the utmost significance to domestic producers of fruits and vegetables interested in this trade, particularly when added to the straight duty cuts which we receive on these items.

Next in importance among the concessions thus far received are those on pork products and lard. On lard, concessions have been obtained in five of the seven agreements, some of them extremely liberal. Cuba, which was once the third ranking outlet for lard, and whose imports of our lard fell from 80,000,000 pounds in 1929 to 11,000,000 in 1933, reduced her duty from a rate equivalent to about 9.6 cents a pound to one equivalent to 2.3 cents during the first year of the agreement and scaling downward to 1.5 cents in the third year. In addition, she agreed to abolish her consumption tax of 1 cent a pound before September, 1936. Colombia, another important market, reduced her rate on lard by 50 per cent; Haiti (provisionally) by 25 per cent; Canada by 12 per cent; while Belgium replaced a licensing system which made it impossible to know how much lard would be admitted, by allocation of a definite quota sufficient to assure us opportunity to compete for a volume of business roughly equivalent to what we actually had on the average in 1929-33. On pork products, concessions have been obtained in every agreement except that with Brazil. On pickled pork, concessions, some of them large, were obtained from five countries which in 1929 took over half our exports. On bacon, six countries which in 1929 took 22 per cent of our bacon exports, granted us concessions, while Belgium also allotted us a definite quota. On hams and shoulders the story is roughly similar. These concessions on pork products and lard have been obtained in the face of protectionist policies so exaggerated that even countries ill-adapted to hog production have, in some instances, given way with great reluctance.

On grains and grain products, the record is not quite so impressive. On

the most important item, wheat, little progress has been made. Partly this is because the agreements concluded are not with countries which have heretofore been primary outlets. Partly, however, it is also due to a peculiar insistence upon protection to domestic wheat-growing which has recently been characteristic throughout the world wherever wheat can be grown. An additional difficulty arises from the fact that, except for soft wheat from the Pacific Northwest, we have for some years been practically out of the world market, our prices considerably above world parity. This not only makes it much more difficult to qualify for concessions on this product on the ground that we are a major supplier to the country in question, but it also serves to cast doubt on our ability to take immediate advantage of such concessions as we do obtain.

On wheat flour, however, and on various other items in the grain and grain products group, concessions of real value have been obtained. Cuba, which is our largest single market for flour, cut her rate on flour milled exclusively from American wheat by 25 per cent, widened her tariff preference, and agreed to abolish within two years her consumption tax of ½ cent a pound. On rice, exports of which to all countries had fallen from 380,000,000 pounds (cleaned basis) in 1929 to 130,000,000 pounds in 1933, concessions or bindings have been obtained from four countries which took about a fourth of our exports in 1933. Important duty reductions have been obtained from Cuba and Canada, while Belgium and Sweden have bound rice on the free list. Canada and Cuba also grant duty reductions on corn, oats, barley, and rye. Five countries have granted us more or less substantial concessions on oatmeal.

Time does not permit a similar account of the other agricultural concessions. Suffice it to say that these have included, among others, such items as: evaporated, condensed, and powdered milk; live animals; various meat products; butter; oilcake; vegetable oils (cottonseed, corn, and soybean); poultry; eggs; a wide variety of field and graden seeds; walnuts; pecans; almonds; peanuts; cornstarch.

No mention has been made of our two most important agricultural exports; namely, cotton and tobacco. Since most countries admit cotton free of duty or at nominal rates, the most that can be done directly on that item is to obtain a guarantee of continued favorable treatment. The agreements with Canada, Sweden, and Cuba do this. Indirectly, however, the trade agreements program may eventually do much to assist cotton exports by increasing the capacity of foreign countries to pay for our cotton. With respect to tobacco, tariff concessions or bindings have been obtained in the agreements with Cuba, Colombia, and Belgium, the last a good secondary market. On tobacco, however, our chief obstacle in most of the leading export markets is not the high revenue duties but the existence of tobacco

monopolies. The primary problem as the negotiations progress will be not so much to secure duty cuts as to insure against burdensome and discriminatory buying policies on the part of these monopolies.

So much as regards concessions granted by other countries on our agricultural products. What has been their effect on trade? Except in the case of Cuba, where the concessions are exclusive, the data are meager or lacking owing to the recency of the agreements. In value, our shipments to Cuba of agricultural products on which the chief concessions were granted increased by 174 per cent during the first year of the agreement. In actual quantity, the increases in shipments of the most important items were likewise striking. Shipments of lard to Cuba approximately doubled in spite of a sharp rise in domestic prices and a rapid decline in our total exports of lard. Of other pork products our shipments to Cuba increased by as much as 50 per cent in spite of rising prices and at a time when total exports were greatly declining. Shipments of various other agricultural items, such as rice, onions, and potatoes, rose sharply. Of course, the increased shipments to Cuba were not entirely the result of the Cuban duty reductions. Undoubtedly, our sugar legislation and our tariff concessions on Cuban sugar, together with other economic and political factors, combined to enhance the effect of Cuban duty cuts.

As to the other countries the data are much less adequate. Belgian import statistics reveal heavy increases in imports from the United States during the first few months of the agreement; but certain disturbing factors, such as devaluation of the Belgian currency and the withholding of goods from entry through the customs prior to the coming into effect of the agreement, greatly diminish the significance of the figures. As to Haiti, figures on individual items are not yet published; but it is interesting to note that our total exports to Haiti apparently increased in value by about a fourth during the first five months of the agreement. As regards Sweden, there are preliminary indications of distinctly encouraging increases in shipments of fruit and other concession items. So much as regards results to date.

In order to obtain these foreign concessions, and others on industrial products, it has been necessary to reduce our own tariff rates on both agricultural and industrial items. To suppose, as some apparently have, that the program could be conducted on a more or less exclusive basis of trading industrial concessions for agricultural concessions, is to suppose something that is entirely impracticable. On the export side, every effort is, indeed, made to get agricultural concessions. Nevertheless, nonagricultural industries must also receive consideration. Nor can one ignore the effect of increased pay-rolls in such industries upon domestic outlets for farm products. As regards imports: while our concessions to other countries can, and should, stress reductions on nonagricultural items, it is manifest that

tariff concessions on agricultural products are also justified when it appears that the benefits to agriculture as a whole will far outweigh the possible losses to some particular groups.

Nevertheless, the concessions that have thus far been granted on agricultural imports have been much more noteworthy for the clamor that they have aroused in certain quarters than for any demonstrable and serious damage which they have inflicted, or are likely to inflict, upon domestic producers. With respect to noncompetitive agricultural products, such as coffee, there can, of course, be no injury. But examination of the concessions on more or less competitive items leaves great doubt as to whether, even on these, substantial, immediate injury can have been done to domestic interests; whereas, ultimately, all should be gainers.

Take, for example, sugar. That the net result of our sugar quota legislation and of our reduction of the tariff on Cuban sugar has been to give positive and substantial benefits to both the domestic and the Cuban sugar industries will scarcely be denied. Or again, winter vegetables. The seasonal reduction of duties on vegetables from Cuba has been the subject of strong protest from Florida and other producing areas. But when all is said and done, careful definition of the seasons of reduced duties has greatly limited the possible extent of any increased competition from Cuba. In view of the extremely valuable concessions for winter vegetables in the Canadian agreement, it seems altogether probable that our producers have been gainers, rather than losers, by the program thus far.

When one turns to the Canadian agreement the situation is similar. Despite all protests concerning our agricultural concessions to Canada, the simple truth is that, while these concessions should prove of distinct value to the Canadians, they are not such as to warrant more than a small fraction of the protest that they have aroused. On cattle weighing over 700 pounds the duty was reduced from 3 cents to 2 cents a pound on a quantity equivalent to about 156,000 head—$\frac{3}{4}$ of one per cent of our average total slaughter of cattle and calves in 1928-32. Even the reduced duty is $\frac{1}{2}$ cent above the high duty which was in effect prior to 1930. Similarly, on dairy cattle and calves there are duty reductions on a limited number of animals. These reductions come at a time when, because of the inroads of the drought on our herds, cattle prices in the United States are already so far out of line with those in Canada as to attract very considerable numbers into our markets over the normally prohibitive tariff of 3 cents a pound. On cream a reduction of the duty from 56.6 cents to 35 cents a gallon is limited to 1,500,000 gallons. This is equivalent to about $\frac{1}{10}$ of one per cent of our annual production of milk and to $\frac{8}{10}$ of one per cent of our production in the North Atlantic States, the principal area in which the Canadian cream will compete.

On certified seed potatoes there has been protest against the duty re-

duction. But this reduction is limited to a quota of 750,000 bushels, equivalent to a little over 5 per cent of our domestic production of seed. Meanwhile, Canada has agreed to give us most-favored-nation treatment on table potatoes, which, for the present, means free entry. Prior to 1930 we shipped her well up toward $1,000,000 of potatoes annually in spite of a substantial duty.

In any event, it would be improper to look at the trade agreements program and its effects upon agriculture simply from the point of view of concessions on agricultural items. Nothing could better emphasize this fact than the Canadian agreement itself. Even on agricultural products, Canada granted us concessions on items to a total value greater than that of our agricultural concessions to her. But the significance to American farmers of her industrial concessions must also be taken into account. On nonfarm products Canada has granted us concessions on items of which she imported $400,000,000 from the United States in 1929-30 (Canadian fiscal year ended March 31, 1930). By 1934-35 their value had declined to $100,000,000. The new agreement, together with continued economic recovery in both countries, should enable us to recover a large part of this lost trade. Fully half of such gain should be reflected, directly or indirectly, in increased domestic pay-rolls. This should mean an increased domestic demand for products of both farm and factory. The same reasoning applies to the other trade agreements. From the seven countries with which agreements have been signed (including Canada) we have obtained concessions on nonagricultural items of which we exported some $589,000,000 to them in 1929. By 1933 the value of these items had fallen to $148,000,000. These figures should convey something as to what the nonagricultural concessions may mean to American farmers.

Such, then, are the salient facts in the record to date. Though they clearly represent definite gains in the way of reviving our foreign trade, advantageous alike to agriculture and to the country as a whole, they will perhaps seem much less impressive to some than to others. So far as agriculture is concerned, it must be clear that the ultimate possibilities of the program will be far from achieved so long as it fails to include agreements with the United Kingdom and Germany. This is simply owing to the overwhelming importance of these two countries in the past as markets for our agricultural products. Even excluding cotton, their importance as market outlets is great; but of course their capacity, particularly that of Germany, to buy more American cotton will be also increased if they are enabled to sell more goods to the United States. None recognize these facts better than the officials themselves who are in charge of the trade agreements program. Unfortunately, however, the obstacles to negotiation with these two important countries have been such thus far as to prevent the initiation of active negotiations.

Before rendering any judgment concerning the trade agreements program, it is necessary to bear in mind some of the circumstances and difficulties accompanying its execution.

First of all, it will be well to disabuse ourselves of any notion that the Trade Agreements Act affords a means of achieving rapid and spectacular results. If others have supposed that it would, certainly those who drew up the Act never so assumed. The truth is the method itself is not one adapted to achievement of speedy results. To organize and plan the execution of the program in the thorough manner required to make it really effective and as likely as possible to avoid serious inequities, is itself a large task. Moreover, even under the best of auspices, the conclusion of individual agreements with a long list of countries—involving in each case an extended period of preparation for the negotiations, hearings for the interested parties, and finally, the higgling and haggling over rates and other matters—could scarcely be expected to move at a rapid pace.

But as a matter of fact the auspices have not been ideal. All of us know how formidable and complex are the obstacles to international trade that have come into being in recent years. Only those, however, who have been at direct grips with the job of seeking to remove these obstacles are likely to realize the full extent of the difficulties they present to trade negotiation on terms calculated to achieve constructive and lasting results. A galaxy of arbitrary trade control devices, Machiavellian alike in technique and effectiveness, has driven such foreign trade as could survive more and more into artificial channels determined by policies of bilateral balancing of trade with individual countries. Exchange controls, clearing agreements, quotas, licenses, and other devices have been employed by country after country to protect domestic currencies and to shelter domestic industries and agriculture. Serving only to intensify the use of such devices have been the efforts of exporting countries, through export subsidies and currency devaluation, to force their exports upon countries unwilling to receive, or unable to pay for, them. The result has been the growth of policies and commitments which make it exceedingly difficult in many cases to establish bases for trade negotiation consistent with the broad principles wisely laid down in the Trade Agreements Act.

The cornerstone of the trade agreements program is the unconditional most-favored-nation principle. Under the Trade Agreements Act the President is required to extend to all countries which are not discriminating against our commerce or pursuing policies tending to defeat the purposes of the Act the benefits of the concessions which we grant to a particular country in our trade agreement with it. In return we assure that any concession which the other country grants or may hereafter grant to any third country shall likewise be extended to us. The purpose of this is to do away with policies of discrimination and retaliation, which lead to trade wars and

general anarchy in international commercial relations, and to assure, instead, equality of treatment on a basis conducive to the expansion, rather than the further contraction, of international trade. If the tide is to be turned away from contractionist policies harmful to all nations, it must be done on that principle.

It is necessary here to be more specific. What we seek is more trade. We cannot get it by creating less—by resorting to the drastic, discriminatory, and trade-paralyzing practices which other countries, harder pressed than we, have been employing to their own sorrow. But that does not leave us helpless in the face of these practices. Under our present policy the tariff reductions which we make are generalized only to countries which are not discriminating against our commerce. That is to say, we do penalize countries which discriminate against us. On the other hand, we accord equalty of treatment to those countries which accord it to us. We extend freely to non-discriminating countries the benefits of the concessions which we extend to a particular country with which we make a trade agreement. And reciprocally, we assure that our export industries will likewise receive the benefit of any concessions which the other contracting country may extend to third countries. By confining concessions in our trade agreements to items of which either country is a major supplier to the other, we are enabled successfully to combine a policy of tariff bargaining with adherence to the unconditional most-favored-nation principle. To abandon this principle in favor of exclusive, bilateral agreements or of bilateral, or perhaps even triangular, bartering, would be shortsighted and futile. It would be simply going over to the system which has already played havoc with international trade. It would undermine the whole basis for going forward with a program calculated to undo some of the damage for which our own past tariff mistakes have been in no small degree responsible.

The complicated nature of the trade barriers in foreign countries is not, however, the only obstacle on the foreign side. Another is the peculiar reluctance of foreign countries to grant concessions on agricultural products. So firmly intrenched has the idea of economic self-sufficiency become throughout the world, it is with the greatest difficulty—especially in the present state of international insecurity—that nations can be persuaded to reduce import restrictions on any agricultural product which can be grown within their own boundaries at less than a prohibitive cost.

Further difficulties arise from misunderstanding of, and opposition to, the program at home. Some of this is natural and to be expected. It would perhaps be a little too much to expect enthusiastic support of the program from those powerful groups which profit by high protection and are more than glad to insist upon continuance of that particular form of government interference with private business. This, of course, only emphasizes the

necessity of seeing to it that the claims of such industries are carefully sifted in order to insure against any serious inequities.

There is, however, not a little misunderstanding and criticism of the program in other quarters, some of it superficial, some not. Some of the most insistent criticism of the program is based upon misconceptions that indicate a total lack of understanding of the problem. Even certain periodicals which have long advocated tariff reduction are finding each new agreement entered into an occasion for disappointment because it does not wholly conform to certain preconceived ideas as to the degree of reduction of our own tariff which is economically feasible or politically possible at this time.

Then again there are some, including a few economists, who, though professing to recognize the need for restoring our foreign trade, nevertheless find occasion to oppose this particular method of doing it. Some of them think it would be wiser to wait until the exchange parities of the leading world currencies can be stabilized. Others hold that the program is unsound in that it fails—at any rate as thus far applied—to work toward an adjustment of our international balance of payments in accord with our position as a creditor nation interested also in maintaining and expanding its export trade. Some even deny that we are any longer a creditor nation—quite mistakenly, I think. And so it goes.

I would be the last to deny that there is genuine merit in some of these criticisms. But I do deny that any of them is sufficient to nullify the usefulness of what has thus far been accomplished or to imply that the present program should not go steadily forward. That the achievement of exchange stabilization would, indeed, lessen the difficulties and add to the effectiveness of the program is not to be denied; just as, conversely, a recession of trade barriers would make it easier to maintain exchange stability. But even before the world's currencies are formally and definitively stabilized, a substantial measure of demobilization of trade barriers is possible on the basis of *de facto* stability. All of the trade agreements which we have signed with European countries contain a provision designed to meet the situation which would arise in case of extreme future fluctuations of exchange.

Similarly, there is logic in the contention that the implications of our international creditor position are such as to call for an adjustment, sooner or later, of our trade balance to a debit basis and that the trade agreements thus far concluded do not, to say the least, furnish clear-cut evidence that they will work immediately in that direction. That, however, is a far cry from saying that the trade agreements program will not, in the final analysis, work that way. What is of surpassing importance at the moment is that world trade barriers (our own, especially) be reduced and the volume

of international trade greatly increased. If that is done, we need not worry too much as to whether a particular agreement tends to increase trade between the two countries somewhat more in one direction than in the other. With the volume of world trade greatly increased, adjustments of international payments will be much easier all around than they are now and the need for particular countries to resort to trade-throttling devices in order to protect their currencies will gradually disappear. International payments will then not only be balanced, but they will be balanced on the basis of a high, rather than a low, volume of international transactions. And that, after all, is what matters most.

The implications of what has been said should be clear. In the interest both of agriculture and of the country as a whole there should be such a widespread public support of the trade agreements program as will assure its continuance and expansion. If collateral measures can be taken to enhance the effectiveness of the program, well and good. And by the same token, if measures are contemplated which would seriously interfere with the program, they should be applied only under superior necessity. Much of lasting value has already been achieved through the Trade Agreements Act. With the support of an informed public opinion, much more can be accomplished in the future.

THE FOUNDING AND EARLY HISTORY OF THE AMERICAN ECONOMIC ASSOCIATION

By Richard T. Ely
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"Great oaks from little acorns grow." How great the oak is amply demonstrated by the size of the assembly upon this fiftieth anniversary. It is a fact known to all who are familiar with our economic ideas and our economic institutions that the American Economic Association has entered into the life of the American people and is one of the agencies that make it what it is. Without it neither the New Deal nor the old could be understood.

Is there anyone in this gathering who knows quite how small the acorn was that was planted at Saratoga on September 9, 1885? Perhaps Professor Seligman knows the story better than anyone else now living. But even he may not know with what pains, and I may indeed say, with what pain, the ground was tilled and with what care and anxiety a very little acorn was kept alive and nursed as it grew during our first few years of existence.

I recall clearly the meeting we held at Saratoga and I can see, as if it were yesterday, Professor Seligman tramping through the rain with me to the office of the Associated Press to see that we had such publicity as we both felt we deserved! Professor Seligman then, as always, put his shoulder to the wheel when that was necessary and always exhibited courage when that was required.

When we hold our meetings now, we raise the question when some particular city is proposed for our next annual meeting whether or not the city's accommodations are adequate for our general meetings and for our many conferences or round tables. At our meeting in St. Louis when our headquarters were at the Statler Hotel all of us felt that we were too crowded and must have more space in the future.

At our modest beginning in that first meeting in Saratoga there were less than fifty—a small room held us all, even counting all those who were there because of curiosity. For many years any one of our larger universities had auditoriums quite ample for all those who attended.

For the first seven years my office as Secretary was a part of my general office at the Johns Hopkins University. The size was perhaps 12 x 20. At first that was the secretarial office, editorial office, publishing office, and I don't know what else besides. There was no appropriation for secretarial assistance and at first not even a typewriter. If some of the earlier letters that I wrote during these days chance to be in the possession of any of you present, I think you will find they are written in my own hand—and, what trouble they must have given you in deciphering them! I took care of the printing, rushing down to the printing office and sometimes

exploding with youthful wrath on account of the delay in getting out a monograph. I made all the contacts and contracts with book dealers like Putnams and the Chicago Retailer who sold more of the monographs than any others. If there is no one else who can be designated by the name of advertising manager, I claim that title!

Now and then! The last time I attended a meeting of our Executive Committee in New York we debated the question, how shall we invest something like $5,000? In our early days, the problem was how to get money for the next step in our activities—for example, the publication of a monograph. Perhaps if I can claim credit for any virtue, it is that of persistence. I was almost ready to go out on the street corner and pass the hat. While I never quite did that, once when our finances were in a bad state, I recall writing to a distinguished New Yorker, Abram S. Hewitt. I asked him to help us out with a life membership. This he generously did and mildly reproved me because I had not written to him earlier! Need I say that this gentleman who did so much for New York and the country holds a warm place in my heart.

Looking through our annals, the economists who delve into our past history will find that Francis A. Walker was President for the first seven years and I its Secretary for the same period. This has a significance that I presume very few present will fully understand. Perhaps Professor Seligman does and he may be the only one listening to me who could explain this long tenure of office of the Secretary and President. I shall try to make this clear, because unless one understands this phase of our early history, one does not have an adequate knowledge of our American economic thought.

What was the condition of economics in the United States in 1885? For one thing, what Walter Bagehot called "a crust" had been formed over economics. That was true in England and it was still more the case in the United States. There were very few Chairs of Economics at that time. Perhaps the first one that existed in this country was the one established at Harvard and occupied in 1871 by C. F. Dunbar. Work was already going on at Columbia before 1880, and in 1881 I began my eleven years at the Johns Hopkins University.

The apparent absence of careers at that time for young men who might desire to devote themselves to economics was undoubtedly an obstacle in the development of economics in the United States. Perhaps a personal anecdote might help to clarify the situation. My father, who was a civil engineer, said to me not long before 1885 something like this: "Richard, you are a young man. Some day you will want to get married and have a family. How can you expect that economics will support you?"

It was along toward the middle of the nineties when Dr. H. C. Taylor received an admonition from Secretary of Agriculture Wilson in almost

precisely the same words: "Taylor, you are a young man. Some day you will want to get married and have a family. Agricultural economics will never support you. Take up some practical subject like plant pathology and I will give you a job!"

But I have not told what is after all more significant about the prospects for scientific work in the economic field which greeted the group of young rebels who returned from Germany about 1880. So far as influence in the colleges and universities was concerned and also in the organs of opinion, especially the New York *Nation,* a group of older men had almost a monopoly, exercised at times with a good deal of harshness. Who were these older men? Godkin and his associates who controlled *The Nation* perhaps come first; then Professor William Graham Sumner of Yale, David A. Wells, the amiable Perry of Williams College, and the belligerent Simon Newcomb of the Naval Observatory and of the Johns Hopkins University. These men of the older generation had done some good things in their day. I would not want to deny them their meed of praise, but our new economic thought disturbed them and they considered us a menace to the welfare of the country. Generally speaking, they had taken over the English classical economics in a rather extreme form and this placed them with those English economists called by the Germans, the *Epigonen—Epigones.*

Free trade and laissez faire were the principal features of their orthodoxy and orthodox was a great word in the early eighties in this country. If you were held to be unorthodox, it was a terrible indictment. They held to absolutism of theory in its two forms—cosmopolitanism and perpetualism. It is hard for the economists of today to understand the situation of those who had the monopoly or near monopoly of which I have spoken.

In 1885 the man on the street thought of political economy as a controversy between freetraders and protectionists. If it transpired in conversation that I held the Chair of Political Economy in the Johns Hopkins University, I was almost invariably asked, "Are you a freetrader or a protectionist?" Freetraders were orthodox. Protectionists were unscientific and in all probability had been bought up by the tariff barons! For them there was no hope in this world and there was no place for them—especially if they hailed from Pennsylvania—in the paradise reserved for good economists!

Here again I venture to give a personal anecdote to illustrate the condition of thought on the part of many of the highly educated and cultured graduates of 1880. It was well along in the eighties when I used to write for the *Baltimore Sun.* In one of these articles I brought out the idea of relativity in regard to free trade and protection—namely, policy had to be adapted to conditions of time and place—an idea that you accept now

as a matter of course. A well-educated gentleman by the name of Davis, living in Charlottesville, Virginia, wrote me a letter expressing warm appreciation of my article. His conscience had been troubled by the fact that this was a protectionist country. Perhaps he felt a good deal as Professor Perry of Williams College; namely, that a sufficient argument against the protective tariff was, "Thou shalt not steal." The idea of relativity in our policies lifted the weight off his conscience.

This is not the time to give you the various platforms and statements of principles which we considered in founding the American Economic Association. The platform as proposed by Dr. E. J. James and Professor Simon N. Patten was one of great length, taking up practical policies and proposals for economic and social reform. The name that they proposed was the Society for the Study of National Economy. They laid special stress upon the necessity for governmental intervention in order to secure "all conditions of a sound industrial system." This platform rested on too narrow a basis to enlist the sympathy of a sufficiently large group of American economists. I then drafted a statement of principles which has been published elsewhere and I proposed that our organization should be called the American Economic Association. I took more of what might be called the "middle of the road" position. What I presented was toned down and modified in the direction of conservatism. Our statement of principles, it is well to emphasize, was never regarded as binding upon individual members. It stated my own views and purposes and was accepted at Saratoga, although doubtless there were those who, while ready to go along with us, would have favored some sort of modification of these principles. Professor Patten, for example, afterwards expressed the opinion that we did not emphasize sufficiently the principle of deduction.

The statement of principles reads as follows:

1. We regard the state as an agency whose positive assistance is one of the indispensable conditions of human progress.

2. We believe that political economy as a science is still in an early stage of its development. While we appreciate the work of former economists, we look, not so much to speculation as to the historical and statistical study of actual conditions of economic life for the satisfactory accomplishment of that development.

3. We hold that the conflict of labor and capital has brought into prominence a vast number of social problems, whose solution requires the united efforts, each in its own sphere, of the church, of the state, and of science.

4. In the study of the industrial and commercial policy of governments we take no partisan attitude. We believe in a progressive development of economic conditions, which must be met by a corresponding development of legislative policy.

The most fundamental things in our mind were the ideas of evolution and of relativity. I think that these two ideas were unanimously held by those who founded the American Economic Association. A new world was coming into existence and if this world was to be a better world, we

believed we must have a new economics to go along with it. The old economists, however, held the idea of a body of established truths arrived at chiefly by deduction, based upon certain traits of human nature and familiar observation.

At that time an active member of the English Political Economy Club, Lord Sherbrook (Robert Lowe) stated that political economy was an almost finished product. Even John Stuart Mill, in whom new life was stirring, said that the theory of value had been so well and so completely established that little remained for subsequent writers to do, except, of course, to learn this theory!

Many entirely misunderstood our emphasis upon historical, statistical, and inductive research. When there is a great strife about what seems like something entirely insignificant, perhaps the spelling of a Greek word, there are always deeper causes at work.

We called ourselves the Historical school, taking the name used by our German teachers. A writer recently has spoken of the barren strife about method which is alleged to have prevailed among the men who were teachers of us young rebels. Karl Knies was one of the founders of the Historical school in Germany. I studied under him and he examined me for my Ph.D. Certainly he was a deductive thinker and one of the earliest advocates of the development of statistics, having written a little work on that subject in 1851. I cannot recall any discussion of method in all Knies's lectures that I listened to. I can say the same of Adolf Wagner when I was a member of his seminar in the Royal Statistical Bureau and listened to his lectures at the university. I think I may say the same of Professor Conrad, of Halle, who married the daughter of Hildebrand, one of the founders of the Historical school. What they were really after was to break the crust that had formed on economics. More than that, all these men were humanitarians and wanted to help bring about a better world in which to live. Karl Knies at least was internationally minded, regretting that Bismarck had not made the mark the equivalent of the English shilling because that would have helped to establish the world money *(Welt Geld)* which would have promoted sound economic international relations.

What I said about the German Historical school applies equally in this country, although in Germany, as in this country, one or two were inclined to replace economics with economic history.

We rebels were fighting for our place in the sun. We wanted the right to exist scientifically and to express ourselves in writing and in teaching.

Now those of the younger generation may well raise the questions: Was there any need of belligerency on our part? Did we have to fight? Here I must be autobiographical. I did have to fight and the fight at times was bitter. It descended upon me more than upon anyone else because I was thought to be the leader. In one particular case, I have been told, I am

inclined to think with some reason, that there was a concerted plan to oust me and then to proceed against those who were considered less dangerous, taking up men like Seligman and even our beloved J. B. Clark!

Now and here I must be content with one or two striking illustrations, deferring the full documented description of the situation to a later occasion. Shortly after the American Economic Association was founded, the then President of the Baltimore and Ohio Railroad gave a talk at a small gathering in the St. James Hotel when President D. C. Gilman of the Johns Hopkins University was present. In his remarks he observed that so long as Professor Ely held the Chair of Economics in the Johns Hopkins University, he and his friends would not send their sons to us. President Gilman did not even mention this to me and I was treated well at the Johns Hopkins University, where an atmosphere of research and freedom of utterance has always prevailed.

It was about this time that Professor Simon Newcomb reviewed my pioneer work, *The Labor Movement in America,* in the New York *Nation,* stating that a man who held such views was not fit to hold a position in an American university. This particular instance has more of a bearing upon the development of economic thought in the United States than might at first appear. John R. Commons, then a student in Oberlin College, read the review and as he has said in his autobiography, *Myself,* he immediately decided that Professor Ely was the man he wanted to study under. That brought him to us and was the beginning of a life-long association.

Professor Taussig did not at once join the American Economic Association. When he read Newcomb's review, he immediately sent in his application for membership, writing me a most encouraging letter. Thus, Professor Taussig joined our ranks and has been a great credit to the Association from that day to this.

The founding of the American Economic Association was greeted with an enthusiasm which cannot now easily be understood. Why? On the one hand, those who were scientifically inclined saw opening up before them a vista and a vision. Economics was not a dead thing of the past, but a live thing of the present, inviting young men to put the best they had into this field. On the other hand, humanitarians felt that no longer were their efforts for improvements balked and frustrated by the so-called laws of economics. To how many of you does Elisha Mumford and his book, *The Nation,* mean anything? It signified a good deal at that time. It was a very able protest against an atomistic and individualistic theory of the state. Perhaps more of you remember Washington Gladden, who wrote several economic books of merit and was a power in the country in the eighties. By both of these men, the founding of the American Economic Association was greeted with enthusiastic joy. If you read *The Nation* on the one hand and on the other read Lyman Abbott's *Christian Union,* after-

wards called *The Outlook,* you will get some idea of the ferment in economic thought going on in this decade. I recall one editorial in the *Christian Union,* in which Abbott emphasized the fact that a new economic world needs a new economics. Article after article appeared, all of this import, and in support of the young rebels.

When I was a young fellow just starting out in the Johns Hopkins University, Lyman Abbott, later editorially associated with Theodore Roosevelt, was a power in the land. He wrote this to me, "I want you to be my teacher." Wasn't that a thrill! The last time I saw Lyman Abbott, he was an old, feeble man giving a war address in Philadelphia. After the meeting I went up with Professor E. A. Ross to congratulate him. Turning to me he said, "You have been my teacher."

I have already mentioned the fact that Francis A. Walker was our first President and held that position for seven years. Walker belonged to an older generation, but we all admired him greatly because he was bringing new life into economics and had broken the crust of the old economics. He had been treated at times even contemptuously by the Old Guard and felt keenly the injustices that had been done him. Elsewhere, I have quoted from a letter he wrote to me personally, in which he expressed his feelings keenly about the unjust treatment to which he had been subjected. Professor Seligman elsewhere has quoted from a letter written by Walker about this time. We turned to him as our leader and were proud to hail him as chief. He on the other hand was thrilled by the thought that we of the younger generation were giving him support and were to carry on our activities in the free and scientific spirit which always characterized his writings. He was reluctant to remain President so long, but he yielded to my persuasion. I felt that until the new Association was thoroughly established, he should hold the presidency, and I felt the same way about the onerous position of Secretary.

In 1892 Walker and I felt that the Association was thoroughly established and any doubts about its future disappeared from our minds; accordingly we relinquished our offices with the assurance that they would be vigorously filled by our successors. Professor J. Laurence Laughlin in the *Journal of Political Economy* has entirely misconstrued this change of officers, stating that it indicated a swing to the right. This is not at all in accordance with the facts. While we did elect as our second President, Professor Dunbar of Harvard and while he was a progressive of the old school, but still of the Old School not fully understanding, we felt, the significance of the American Economic Association, we elected him without opposition and with my own hearty indorsement. We admired his sound scholarship and the work he had done. His election signified neither a swing to the left nor to the right, but catholicity. I nominated my successor, Professor E. A. Ross. Think of the selection of Ross as a swing to the right!

The year 1885 may be designated as our hegira—the flight from the old to the new! It is beyond question that, even if the American Economic Association had not come into existence, we should still have had a development of economic thought in this country; but it is certainly true that our Association gathered together the vital thought-forces of the time and gave expression to them.

Economic associations in other countries quickly followed the founding of our Association. Correspondence in our files shows that to some extent at least we furnished the suggestion and the inspiration for three other countries. These three countries are Great Britain, South Africa, and Japan.

Let me illustrate the nature of our early activities by a few references to our publications. The functions of the state, in relation to public utilities, were discussed in Dr. Edmund J. James' monographs on *The Relation of the Modern Municipality to the Gas Supply* (in Volume I of the Publications of the American Economic Association), and on *The Railway Question* (in Volume II). The principle of competition, as a regulating factor in the sphere of industry, was ably examined in a monograph published in Volume I by Professor Henry C. Adams, entitled, *The Relation of the State to Industrial Action*. In this monograph Professor Adams reached the conclusion that competition may generally be relied upon to regulate, in the interests of society as a whole, those industries where conditions of "constant returns" or "diminishing returns" prevail. So far as businesses conducted under conditions of either constant or diminishing returns were concerned, Professor Adams maintained that the entrepreneur's struggle for superior success was usually "a struggle to depress the cost of rendering services rather than to raise the prices of services rendered." But a third class of industries existed, he said—those conducted under conditions of increasing returns. Businesses conducted under conditions of increasing returns, he maintained, could never be regulated by free competition, "because it is easier for an established business to extend its facilities for satisfactorily meeting a new demand than for a new industry to spring into competitive existence." Thus, in the third instance, we have, he said, a case of natural monopoly, where state regulation and control is an imperative necessity if the general welfare of society is to be considered.

It is noteworthy that both Professor E. J. James and Professor Adams arrived at similar conclusions, though by different routes; namely, that public utilities, etc., must be subjected to public control.

In this same Volume I, we find two monographs on co-operation; one by Albert Shaw, entitled, *Co-operation in a Western City*, and the other by Edward W. Bemis, entitled, *Co-operation in New England*. In Volume II we find another monograph on the same subject, Amos G. Warner's *Three Phases of Co-operation in the West*, and also a *Historical Sketch of the Finances of Pennsylvania*, by T. K. Worthington. These monographs on co-operation and the one on the finances of Pennsylvania were written by

students of mine in the Johns Hopkins University, and, in their insistence on observation, they show the influence of the German Historical school. I believe that all the founders of the American Economic Association, whether their writings tend to be deductive or inductive, have taught their students to use the "look and see" method. In Volume III, Professor J. B. Clark published his essay on *Capital and Its Earnings,* which contains the essentials of his entire economic system. In the same Volume our first President, General Walker, presented a paper on the *Efforts of the Manual Laboring Class to Better Their Condition.* In this paper General Walker showed that, although the workers had "as real, as large, as vital a part to perform in securing a just and beneficial distribution of the product of industry" as the employers, it was, nevertheless, unquestionably true that every permanent increase of wages depended also upon the accumulation of capital for industrial uses.

One of our members has urged me to give anecdotes about our early meetings. He said, "Make it personal. Tell us something about your controversies. Didn't the fur fly sometimes?"

There was some pretty animated discussion of a more or less controversial nature at our first meeting in Saratoga. We certainly, however, soon came into smooth waters. I recall that after we had been in existence six or seven years, Henry C. Adams complained that the meetings were losing interest because our thought was so similar. Since then there has been more controversy and I think that at some of our recent meetings, there has been enough strife to gratify those who love a fight. Now we have the New Deal with us and I anticipate fights gratifying our most belligerent friends and perhaps even recalling Donnybrook Fair!

I recall one instance of a most gratifying nature. After Professor Patten returned from Germany, he taught a country school in Illinois and it was several years before he received a university position. His dearest friends, of whom I count myself one, must admit he was something of a rough diamond in his early days. It is to the credit of Dr. E. J. James that he had faith in the great ability and future career of Simon Patten and was responsible for bringing him to the University of Pennsylvania where he did such remarkable work both as teacher and writer. At one of our earlier meetings Professor Patten read a paper on Ricardo and Malthus. When he finished reading that paper, he took his place among the American economists of distinction. As Secretary, I sat on the platform and looking into the faces of the members present, I could see as plainly as I see your faces that he was fully received into the guild of economists.

Now let me give you another anecdote connected with our early days. Patten expressed the thought that our consumption in this country was not suitable to the American environment. Among other things, he thought we should eat more corn bread and less white wheat bread. Shortly after I was married, he came to Baltimore to spend a week-end with me. My wife

had been delving into Patten's economics. She felt she must do her part to help bring about right consumption. As a Virginian, she knew all about the endless varieties of corn bread in her native Virginia; so we fed it to Patten on every occasion. Unluckily, it did not seem to agree with him. He had to get up at night and take a train back to Philadelphia the next morning. Thus ended a bride's attempt to save the country!

One more anecdote. Women have always been welcomed into our ranks, but in our early days there were few of them. When we held our first annual meeting in Philadelphia there were perhaps fifteen or twenty women present, some of them women of distinction, for example, Florence Kelley and President Thomas, of Bryn Mawr College. Dr. Stuart Wood promised us a reception in his beautiful home and announcements were printed to that effect. He had evidently overlooked the fact that women were members of our Association, and according to the inflexible social code of Philadelphia, he did not see how he could receive women and men both in his home. So it fell to me unhappily to tell our women members that they were not expected at Stuart Wood's reception. In an eleventh hour attempt to smooth over an embarrassing situation, Dr. Wood's sister offered them a reception in her home and extended to them all a most cordial invitation to attend. The good ladies boycotted this reception and while the men enjoyed Dr. Wood's hospitality, his sister's parlors, all brilliantly lighted in anticipation of the ladies' arrival, were empty. How times have changed since then and perhaps even in Philadelphia!

In this address I have touched only the high spots. Will you pardon me if I again become personal and to some extent autobiographical? If by the Grace of God, health and strength are spared me, it is my purpose to continue work on a treatise already begun, of which this paper, greatly expanded and documented, will form no insignificant part, and in this treatise I shall endeavor to show how it is that we think as we do in the United States in economics. What I have already begun and what I have planned is something far more than a history of academic economics. It is a story of those forces and those ideas that in this country have shaped our thought, which by no possibility can be understood unless we consider the statesmen who have been active among us from the time of Benjamin Franklin on, and the journalists like Horace Greeley who have done so much toward controlling the economic ideas of our country. And I may add what Henry Ford and his automobile have done to our thinking.

For us old duffers, as Professor Seligman calls us, 1885 was *Morgendämmerung*—the dawn of day. For us it is now *Abendämmerung*—twilight—the shadows lengthen. But generation follows generation. As I look about on this gathering and see your youthful features, I likewise see everywhere the promise of an advance in economic thinking beyond what we, the founders, have known. It is not *Abendämmerung* for the American Economic Association. It is *Morgendämmerung*.

DEVELOPMENTS IN ECONOMIC THEORY

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In reviewing economic theory in Europe during the last fifty years, several points of view suggest themselves:

1. The development along national lines, such as English theory, with its ramifications in Scandinavian countries, Holland, and to some extent in Germany, in which the stress was laid on analysis of problems close to reality. Or the German method (a method equally characteristic of Austria and former Austrian countries, such as Czechoslovakia and Hungary, of the Balkans, of Russia before the Bolsheviks seized power, and to a large extent of Scandinavia) which was more concerned with abstract problems, in contrast with the English, and, even more, American writers, who were loath to indulge in pure abstractions or to map new systems of theory.

2. Developments according to general problems, such as the theory of value and prices, of distribution, and the theory of dynamic processes, as for example the business cycle.

3. Developments of the process as a whole, such as the stationary process, the dynamic process, and the theory of different social structures, as market economy, monopoly-capitalism, and socialistic planned economy.

4. The development of monetary theory including banking with special attention to the business cycle.

5. The point of view of modern psychology, behaviorism, institutionalism, as a counterweight to the abstract, pure theory, and their influence on the theory of value, distribution, etc.

6. The point of view of special problems in the theoretical field bearing on general theory, as the theory of location (Alfred Weber), the theory of monopoly, the theory of international trade, tariffs, movements of capital, etc., the theory of public finance, and accounting.

7. The point of view of the sociology of economic theory.

The main work of European, continental economic theory has shifted in the years since the War to problems of practical importance. Even the most impassioned theorists could not evade such questions as monetary reforms, political debts and their implications, wages, unemployment, and so on. Characteristic of this period are attempts at explanation instead of description, on the basis of quantitative analysis. Research institutes cropped up like mushrooms, sometimes too bold in their tentative statements, sometimes directed by wishful thinking, but, when we strike the balance, adding to our knowledge considerably. At the same time theorists specialized in particular problems (such as equilibrium, monopoly, elasticity of demand and supply) the analysis of which was developed on the basis

of higher mathematics. This "pure theory" has been confined so far to the problems of a stationary system (circular flow), even when it used data of the dynamic process (for the applied theory of elasticity of demand). Many of these bold ventures were scientific playing of the kind Marshall had in mind when he said, "If we include in our account nearly all the conditions of real life, the problem is too big to be handled; if we select a few, then long-drawn-out and subtle reasonings with regard to them become scientific toys rather than engines for practical work." It remains to be seen, whether these detailed studies will contribute to the analysis of the real dynamic process. Of course, that is not the test for those who believe in the value of logical reasoning as such, even if it has no bearing at all on the real economic process. But few economists will complain that this type of detailed studies has replaced the frequent attempts to evolve new systems and the delight which especially German economists took in "fundamentally new discoveries"—both of these preoccupations being either playing with or a flight from reality.

I shall deal with value and prices, distribution (computation), business cycle theory, and the sociology of economic theory on the Continent primarily.

The theories of value and price are based on the marginal utility principle. This is the main theory followed by economists in Europe; the labor theory of value is still discussed at universities, though not frequently.

This approach to the theory of value is not unopposed, however. Two arguments stand out. First, is the behavioristic argument, based on an empirical psychology, refusing the so-called "psychological foundation" of the marginal utility principle. This argument fails to recognize that the psychology of Gossen, Jevons, or Menger, for instance, is a formal statement consistent with any ways and contents of motivation. The theory would be wrong only if our desires increased in general with our satisfaction of them.

Second, are the attempts to content oneself with the theory of prices as quantities. This is closely connected with the concept of equilibrium. An example is the concept of the market as a system of interdependent quantities (Cassel), and similarly, Flores (Spain) who is in favor of discarding the theory of value altogether by falling back to a system of equilibrium on the lines of the Walras school; or as Bourguin (France) says, "There are functional and not irreversible relations [dependencies] between costs and prices." This, too, throws overboard any theory of value. These views overlook the fact that such an equilibrium system of prices has no meaning whatever unless it is conceived as a system of prices, which leads inevitably to questions as to the principle of prices; viz., value.

More serious is the problem of total value, in cases where the division of commodities in infinitesimal parts is impossible. The process of integra-

tion offers an approach; but here, as in the difficulties of imputation, the theory of costs is called in again. Sometimes a synthesis of subjective and objective theory is suggested, according to which the relations of "objective costs" constitute a skeleton to which the prices must conform eventually, while subjective evaluations determine the short-run prices (and the monopoly prices where competition is not allowed to level the prices down to their costs).

The theories of distribution are based on the marginal productivity principle. The method of variation, first applied by the German economist, von Thünen, is widely used. It should be noted that this marginal-productivity principle (introduced into modern theory by J. B. Clark) depends upon the divisibility of the elements of production and upon decreasing return. Even so, it is exposed to the objection that the variation "at the margin" changes not only the product of the changing factor, but also, by the variation of the composition, the products of all the other factors (Hobson, Pantaleoni, and others). But this ticklish argument may be waived. Greater difficulties are presented by the situation of increasing return (in the case of unused capacity), as then the marginal principle proves to be entirely impracticable (Marshall). The highly abstract nature of this theory leads many theorists to combine it with some hints at reality; thus Aarum (Norwegian) looks for the marginal productivity "at the point of substitution"; that is, at the point where one unit of a productive factor can be used with the same advantage as a certain quantity of another factor, so that each of them can be measured by the other. It seems to me that by this split, the theory of costs enters the scene. Or another economist (Navratil, Hungary) wants to include the element of power, while Nedelkovic (Jugoslavia) adds the "social order" as a "means of production." These "improvements" are convenient—they give elbow-room instead of a strict principle—but for that very reason they weaken the strength of the theory, its primary quality.

In the case of increasing return, no solution can dispense with the principle of costs. But there have been hardly any theorists so far who have dealt with that problem. Theorists in general rely on the law of diminishing returns; they will make the concession that in some cases the returns of further units of a factor, added to a given combination, will surpass the return of the last unit; but they will maintain that the system as a whole will be subject to the law of decreasing return. Well justified as that may be for a stationary circular flow, and though it can even be assumed (under certain conditions) that it holds true for a dynamic system that we make stationary by excluding further growth, it certainly does not hold true in the process of growth. This problem, too, has scarcely been discussed.

The theory of computation is almost identical on the European continent

and in this country. But the consequences drawn, especially with regard to the wages theory, are different. To put it drastically, in Europe it is said that wages can be too high, never too low. If they are too high, permanent unemployment will ensue; if they are lower than the marginal price would allow, the profits will rise and as a consequence, on the one hand, of the additional demand for labor, and, on the other, of the increasing productivity of labor (due to increased accumulation), the wages will rise very soon to their appropriate level.

The contrary view is characteristic of many American economists: the greater danger lies in wages being too low. The purchasing power of the workers will diminish on the market, large-scale production will be abandoned, costs and prices will increase, no new investments will seem promising. Since productivity increases with technical progress a quick adaptation of incomes to the increasing social product is the condition for steady employment. These two views represent different theories, different conditions, and different attitudes. They are a good example of how widely conclusions can differ according to the material of observation.

It may be mentioned, however, that the labor theory of value (Marx) still plays its part in Germany, Italy, and in Russia, especially. This theory (with Ricardo) considers the rent on land as a differential rent, thus refusing Marshall's objections, and it leaves room for using the social phenomena to account for the differences in wages and salaries, otherwise unexplainable by the principle of labor costs. Monopoly prices, of course, are beyond the scope of this theory. But it serves to give a "theoretical description" of the economic system in less abstract terms, it shows clearly the interdependence of the different branches of production and their growth, and it offers at least a hypothesis for the changes of the interest rate through the ages and the problems involved therein. This last fact may explain why the theorists that still think in the pattern of this objective theory of value are concerned mainly with economic structures and their change. For this reason, this theory is considered to be socialistic. On the other hand, this theory offers no approach to a refined analysis of demand and therefore to short-run problems.

The theory of equilibrium is an important part of almost every economic system on the Continent; the influence of Walras and Pareto can be felt everywhere; the economic (stationary) whole is conceived of as a system of strictly and *uno actu* interdependent elements. This is the view also of Barone. Less popular is the Marshallian way of stretching and softening the system in order to obtain practical results.

A general scheme of equilibrium cannot easily serve as the starting point for a dynamic theory; it stresses the forces, eliminating every disturbance, while the dynamic process is nothing but a "system of dislocations." There is, however, an important attempt to extend the limits of the stationary

equilibrium theory (Böhm-Bawerk). Unfortunately he failed in explaining the interest on capital by reference to subjective evaluations, and thus he failed to draw a scheme of equilibrium covering a whole process of development.

Another main problem in European economic theory is still the theory of interest, which was in the center of discussion about twenty-five years ago. While the principle of abstinence (waiting) is the generally accepted basis of explanation in England, the theorists on the Continent are still in search of a point of view that can knit together the theory of interest and the theory of value. The interest on capital, being a price, should be explained—they maintain—by the same principle that rules prices generally. The English view is less abstract; it explains interest rather by the market situation. As there are usually more people who have a need for capital and who can use it with profit, than people who want to save, the interest rate will be positive. The continentals are interested in the problem of why an entrepreneur can offer an interest payment to his creditor; in their opinion, merely to assume that he does it, is begging the question.

The labor theory of value (the followers of Ricardo and Marx) is logical; the interest (profit) is a distinct part of the value created during the process of production, and can be explained on the basis of the general principle of value. The term "exploitation" does not mean, however, that the single entrepreneur exploits his workers personally and that he could produce without "exploiting" them; but that it is the social-economic structure that holds both him and the workers in its grip. There is no doubt that the moral tinge of this theory partly explains the appeal it made; therefore, it should be stressed more that it aims at a consistent "objective" explanation.

The subjective theories of interest are still in an unsatisfactory state. The principle of a lower evaluation of future goods, suggested by Böhm-Bawerk, has not been accepted by European theorists. The idea of the greater productivity of longer, roundabout ways of production is a productivity theory of interest, and is rejected for such good reasons as are given by Böhm-Bawerk himself. Moreover, it seems that the difference between shorter and longer roundabout ways of production amounts to the same as differences in organic composition, which clearly cannot serve as an explanation for interest as a constant income. The scarcity of capital disposition (Cassel) begs the question, as does also the theory of waiting, to which it is very close. Thus the view that interest (and profit) is a dynamic income has won adherents. When this view is accepted as a working hypothesis, reasoning about interest assumes greater elasticity. Interest may drop down to the zero level, even for a long time, without impairing the working of the system while no other price can drop so far. The reasons for the payment of interest on capital may be various, such as, the

market situation for labor, technical progress, and increase in the amount or velocity of money in circulation. Thus in this view interest is tied up with the dynamic capitalistic system, with profits always emerging here and there and wiped out again, while they originate elsewhere instead. As long as the dynamic forces work (the entrepreneur is considered by Schumpeter to be the main dynamic force), a flow of profits will go to the entrepreneur and consequently a flow of interest-payments to the capitalists. If these dynamic forces subside, competition will wipe out profits as well as interest. This theory is the most flexible and, I venture to say, it explains more than any other. If it does not prove to be satisfactory, waiting remains the only possible principle. But this idea leads inevitably to the question why (apart from compensation for risk) a price should be paid for the time during which the capital is used, unless during that time and by the use of the capital, an additional value is created—which again is contrary to the general principle of value—except when that price is considered as a transitory increment due to "regular irregularities," the regular violations of the principle of value within a dynamic system.

I have mentioned that Böhm-Bawerk's theory, though praised with many words, has not been accepted. Few, however, reject it so fervently as Birck, the Danish economist, whose influence on pure theory in Scandinavian countries is decisive.

The theory of the actual dynamic process (that is, of the business cycle) also characteristically digs back to the principle of value. When one starts from equilibrium, how is it possible that disturbances are not ironed out by the working of the basic economic laws, but accumulate, leading to the peak of a boom and, by the collapse of the unbalanced situation, to a depression? Every theory of the cycle has therefore to describe the dislocations from equilibrium, has to give the reasons for their recurrence, and has to show why, then, disturbances accumulate. Almost all the cycle theories agree about the nature of these disturbances—they are disproportionalities. But there are disagreements as to the causes of these perturbations: oscillations in nature's response to human exertions, or the necessarily discontinuous growth of producer's goods; or disproportionality in the distribution of the national dividend; or irregularities in technical progress which, through additional credits or increasing velocity in the circulation of money, accumulate into a boom, once the upswing starts. There are also theorists on the Continent who advance the opinion that the cycle is a "purely monetary phenomenon"; but there is hardly any radical defender of that tenet to be found any more. The discussions of the last fifteen years, however, have led to the general conviction that no cyclical development can be explained or described without taking account of the monetary aspect, additional credit providing the fuel without which any dynamic power would spend itself very quickly.

We can say without exaggeration that the bulk of modern theory is business-cycle theory; but as the American reader can avail himself of a presentation of many of them in Mitchell's first volume on the subject, I have devoted more time to the other problems and propose to add only a general deliberation about the trend these theories seem to be taking now.

As long as the theories of the business cycle were concerned only or mainly with the analysis of the phenomenon, it was attempted to find the cause of it, as if the ten or seven years of the cycle were always the repetition of the same sequence of causes and consequences. Later on, theorists realized the complexities and the historical peculiarities of the special cycles, and their statements assumed the nature of descriptions by means of abstract concepts. One view gained wide support, shared by Spiethoff, Cassel, Wicksell, and Mises and his followers, especially Hayek, but also by Landauer, Robbins, Haberler, Adolf Weber, Bresciani-Turroni, Fanno, and many others; and was dealt with sympathetically, also, by Schumpeter. The salient point of this view is not the lack of proportion between producers' and consumers' goods production—even a blind man can see that that is characteristic of every cycle—but the turn that has been given to the thesis that it is excessive consumption at the height of the peak that leads to a lack of capital and to the breakdown. From this it would follow that lower consumption during the upswing, and especially at the end of it, would save us from collapse. This deliberation *e contrario* shows the fallacy of that argument. In fact nobody will believe that feeding investments on additional savings would prevent the breakdown, which, as far as it is due to the extent of investments, is caused by overinvestment through all the years of the boom, and certainly not by a lack of capital at the very moment of the collapse. Even if the collapse were not apparently caused by the restriction in credits, it would ensue as the consequence of unused capacity or of the headlong fall of prices when the new enterprises begin to work. Thus the emphasis shifts to the lack of sound proportions between consumption and investments during the upswing—a view that is just the opposite of the former thesis, as far as consumption is concerned.

That the lack of right proportions between the different branches or spheres of production breeds the cycle is the view of the theory on Marxian lines, also (f.i. R. Hilferding, R. Luxemburg). But it emphasizes the dislocating effects of technical progress and it deals, furthermore, with one problem, neglected since John Stuart Mill; namely, economic growth. For this theory (R. Luxemburg), economic development is due to special causes, such as exploitation of precapitalistic countries, without which the dynamic process would come to a standstill. This and similar views were widely discussed during the last depression and shared by theorists who would not subscribe to the revolutionary implications of that theory.

The last years have brought a reversal in the orthodox theory. Public

opinion has forced upon governments an active recovery policy that proved to be more or less of a success, which it could not have been if the idea of scarcity of capital and overconsumption had been correct. Gradually orthodox economists, too, began to look favorably at some recovery measures, and to discuss the reasons for their success. (A good survey of the opinion of European economists is contained in the book written in honor of Spiethoff, and published in 1933.) To put it in a general way, the questions were whether the economic system, out of gear after the collapse, must return to an equilibrium by its own automatic forces; whether the "cleaning process" is such a return; and whether a new equilibrium or even upswing can be brought back before the whole system slides down to a point where it would be if no artificial upswing had set in. As the upswing is not only a deviation from the "normal" path of development, but also an acceleration of the normal growth (using reserves of all the factors of production), a positive recovery policy using unused capacity is well founded. In fact, there are very few economists who still stick to the orthodox dogma, pointing, for instance, to the example of Great Britain, which, however far from being orthodox, developed its own policy.

This last great depression will undoubtedly leave its mark on economic theory, which tends now to become realistic in spite of the minute elaboration of the equilibrium problem. European theory is in this field considerably different from American. Since the production of durable consumers' goods does not play the same part as in the United States (motor cars, refrigerators, and so on), extension of consumers' credit during the upswing does not add so much to the dislocation of the system. This difference is shown clearly in the theoretical scheme of the cycle. The concept of purchasing power is not emphasized as it is in the United States.

There is almost unanimity as to the detrimental influence of rigidity, though opinions split on the point whether rigidity of prices (monopolies) or of wages is the main obstacle on the path to recovery. The answer will depend upon whether or not one believes in the scarcity of capital. While these detailed questions were discussed throughout Europe the monetary aspect, though not at all deprived of its influence, was shoved to the background. This change in view is due to a better insight into the swiftly varying velocity of money's circulation (Keynes, Koopmann, Marschak) and to the experience that at least during the depression monetary expansion is unfeasible (thus bringing home the partial truth of the banking theory).

It is difficult to say which are the decisive problems of the present theory —whether the business-cycle theory, with its more detailed analysis of special phases and its closer investigation of history in order to find the special features of the different cycles on the basis of a realistic dynamic theory; or further refinements in pure theory, dealing with questions such as monopoly, duopoly, equilibrium, and so on. Unhappily these two trends of

thought develop separately, and it is difficult to see how they can be brought together. Perhaps theory of a stationary system is necessary in its general outline as the basis for any dynamic scheme—but this requires a theory of its own, and cannot be fertilized by further refinements of abstract and pure theory. Maybe it is too early to say this definitely, but there are indications that it is so.

The business-cycle theory as such leads to the analysis of the capitalistic economic structure. If we can influence the cycle, we can rebuild the whole structure. Thus, systems of interventionism were also investigated and the question how the dynamic circular flow can be influenced to the advantage of the population was discussed. These considerations were not deviating from the path of economic theory. They dealt with the same questions that had been treated by Marshall and Pigou in a more abstract way. But whereas the problems of Marshall and Pigou were the regular problems of quiet, pre-War Europe, the turmoil of post-War conditions proved that a greater range of dislocations can fundamentally change the problem, as the situation may not swing back to a new equilibrium but may drift away from the equilibrium (e.g., in the runaway inflation; or in a depression with 30 to 40 per cent unemployment and so on).

Continental theory was also influenced to a great extent by the Russian experiment. The Russian planned economy, originally aiming at the building up of all the implements of a modern army, developed to a complete scheme of a managed economic system. In Russia it grew out of the necessities of the state, on a scanty theoretical basis or without a theoretical basis at all. In western Europe, the theoretical problems were discussed that would arise in case a complicated capitalistic system should embark on planning, for instance, whether partial control of production (as through cartels, or through socialization of basic industries) or credit control could lead to a planned system.

Two questions stand out. First, whether the planned system can function, as it is not based on a market and as it cannot, for this reason, evaluate the means of production. This fallacy was early disposed of. Second, whether a planned economic system is compatible with democracy. The answer to the second question is beset with evaluations and entails a politico-sociological theory. It is in this field that the old fight between bourgeois and socialist theorists was stirred up again, the bourgeois economists even nowadays, in spite of experiences to the contrary, advocating that a planned economy cannot exist, for economic reasons.

Before I conclude I may refer to the attempts to tie up economic theories with social interests—"interest" taken in the broadest sense of the word. This sociology of science is a problem in our field which attracts the interest especially of the younger generation, under the influence of Marx, Max Weber, Mannheim, and so on. It is not at all a problem discussed only in

Germany, but the northern countries contributed to it as well (Myrdal). In my opinion, the main problem is not so much whether or not the theories proposed are the superstructure of capitalists' or workers' interest (there are hardly fighters for interests in the ranks of our theorists) but, which is more serious, the question whether or not an unconscious bias leads theorists to see or not to see special facts or to give a wrong emphasis to facts. There are many examples (I have hinted at some of them) that prove this danger has not been avoided in our field, as, for instance, in the question of planning or in the discussion on wages (where many economists shun the implications of increasing returns).

To sum up. Continental theory is still haunted by the specter of Malthus' views (that the lack of capital, the increase in population, and the decreasing return are as many obstacles to growth and that they can be overcome by hard work and restrictions in consumption only), while American theory, even where it follows the older lines of thinking, still takes into account the results of mass production, and the embarrassing consequences of increasing returns (in other words, is dealing with the pains of growth).

Thus many European theorists are inclined to trace all our economic disturbances to our poverty. For them the concept of oversaving is sheer nonsense. They know of one remedy only—saving, the formation of capital. American theory stresses the disturbances due to the unused potentialities of our producing system and the merits of spending. This difference, too, is an interesting contribution to our sociology of knowledge.

But, however widely theorists may differ in Europe, all of them abandoned the old notion of an abstract "pure" theory as a guide through the vicissitudes of reality. European theory, too, became more realistic. The reality is approached by theoretical concepts. That is the important change in the general attitude, the results of which, we hope, will meet our expectations.

THE FEDERAL REVENUE ACT OF 1935

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The Federal revenue legislation of 1935 included two main groups of taxes. In one group are the miscellaneous internal taxes which were scheduled to expire by limitation during 1935 unless extended by express enactment; and in the other group are the changes which constitute the Revenue Act of 1935. The extension of the "nuisance" and other miscellaneous internal taxes was not "news," as the reporter would put it. Their continuation was obviously necessary, even from the outset, and the event was in the nature of routine business. This discussion, therefore, will not deal further with them. Nor will it deal with certain other recent expressions of the federal taxing power, such as the taxes to regulate the production of cotton, coal, tobacco, potatoes, and industry generally. The revenue purpose and result of these so-called "taxes" are alike microcosmic, and if they can be defended, it must be on other than fiscal grounds. Their advocates suffer from a complaint which Adam Smith described as the delusion that the sovereign could determine better than the individual owners, the best uses to which their capital should be put.

The Revenue Act of 1935 is a brief measure, consisting of certain amendments to existing federal tax laws. Its creation was inspired by a Presidential message dated June 19, and its enactment was forced through a reluctant Congress by the prospect of a special session otherwise. The request for such legislation as late as the middle of June occasioned justifiable surprise to Congress and the country, for earlier statements had rather definitely dismissed the subject. In the budget message for 1936, transmitted to Congress on January 3, 1935, the following passage occurs:[1]

> While I do not consider it advisable at this time to propose any new or additional taxes for the fiscal year 1936, I do recommend that the Congress take steps by suitable legislation to extend the miscellaneous internal-revenue taxes which under existing law will expire next June or July, and also to maintain the current rates of these taxes which will be reduced next June. I consider that such taxes are necessary to the financing of the budget for 1936.

As already indicated, the extension of the miscellaneous taxes was obviously necessary, and did not require the whip and spur of a special message or the threat of a special session. The events and circumstances that emerged between January and June and that were responsible for the change of attitude are fairly obvious, as are those other certain events which, occurring after adjournment, eliminated much of the urgency and pressure for this legislation. It would be interesting to review these matters, but the present discussion must be confined to the actual legislation and to the considerations expressly advanced in support of its enactment.

[1] *Message transmitting the Budget for 1936*, pp. xii, xiii.

The taxation message of June 19 opens as follows:[2]

> As the fiscal year draws to its close it becomes our duty to consider the broad question of tax methods and policies. I wish to acknowledge the timely efforts of the Congress to lay the basis through its committees for administrative improvement, by careful study of the revenue system of our own and of other countries. These studies make it clear that we need to simplify and clarify our revenue laws. . . .
>
> On the basis of these studies and of other studies conducted by officials of the Treasury, I am able to make a number of suggestions of important changes in our policy of taxation. These are based on the broad principle that if a government is to be prudent its taxes must produce ample revenue without discouraging enterprise; and if it is to be just it must distribute the burden of taxes equitably. I do not believe that our present system of taxation completely meets this test. Our revenue laws have operated in many ways to the unfair advantage of the few, and they have done little to prevent an unjust concentration of wealth and economic power.

This is a fairly ambitious prelude. It covers a territory broad enough to warrant the reader in expecting to find a reasonably well-considered opinion on the major defects of federal tax policy, with equally well-considered suggestions for improvement. Following such a broad announcement of the theme, one might justifiably expect that its development would include, among other things, an exposition of the defects of the protective tariff, and a demand, if not a program, for revision which would go farther than is possible under reciprocity. The protective duties of the tariff law fit perfectly into the language just quoted. Their burden is not distributed equitably; they constitute by far the most impressive example in our whole fiscal experience of taxation which has operated to the advantage of the few and which has promoted the concentration of economic power.

The reader who entertained any such expectations would be disappointed, for the program of tax legislation actually proposed does not deal with clarification and simplification of federal taxation, nor does it deal adequately with broad questions of tax methods and tax policies. It does not even mention the need for revenue. The message asked specifically for three changes in taxation: first, in addition to the existing estate and gift taxes, it asked for a tax on very large inheritances and a counterbalancing tax on gifts, the proceeds of which were to be segregated and applied to the reduction of the public debt; second, for higher surtaxes on large individual incomes; and third, for graduated rates on corporate net income, with taxation of intercorporate dividends to prevent evasion through separate company returns, except in the case of bona fide investment trusts submitting to public regulation.

There is also a blanket recommendation that Congress study and consider a number of other changes, but no subjects are definitely suggested except the ultimate simplification, through taxation, of corporate structures by the elimination of unnecessary holding companies in all lines of business, and the discouragement of unwieldy and unnecessary corporate surpluses.

[2] House Document 229, 74th Congress, First Session.

But these issues are said to be too complicated and difficult to be adequately debated during the present session. The inference is that the tax changes specifically requested involved no difficulties and complexities that could not be disposed of quickly and comfortably.

No one can pretend that this brief, one-sided program, embracing one new tax, rate increases in two other cases, and some vague suggestions respecting further taxation to curb and control business organizations and their practices, does more than touch the broad question of policy hinted at in the sweeping introductory paragraphs, or that it makes any contribution at all to the clarification and simplification of either methods or policies.

The justification of such a program is to be found, if at all, in the argument and viewpoint of the message which proposed it. Before proceeding to an examination of the case advanced in support of the particular changes recommended, the changes themselves should be set forth briefly. This is done in the order established by the Act.

The Changes Made by the Revenue Act of 1935[3]

1. The surtax rates on individual net incomes are increased, beginning at $50,000 of net income. The new rates rise to 75 per cent on net incomes in excess of $5,000,000, as against a top surtax rate of 59 per cent on net incomes in excess of $1,000,000 under the 1934 Act.

2. The rates on corporate net income are graduated and the maximum rate is increased. Instead of 13.75 per cent, the new rates are: on the first $2,000, 12.5 per cent; on the next $13,000, 13 per cent; on the next $25,000, 14 per cent; and on net income in excess of $40,000, 15 per cent. If a consolidated return is made, a privilege now confined to railroad corporations, the tax shall be at the flat rate of 15.75 per cent. Corporations are permitted, for the first time, to deduct contributions to welfare agencies, to an amount not exceeding 5 per cent of the net income. But as an offset to this surprising bit of generosity, they may deduct from gross income only 90 per cent of the dividends received from domestic corporations subject to the Act.

3. The capital stock tax was increased from $1.00 to $1.40 per $1,000 of the adjusted declared value of the stock. A new declaration of value is to be filed.

4. The rates of excess profits tax were increased and graduated. This measure was introduced in 1933, at a rate of 5 per cent on that portion of the net income in excess of 12.5 per cent of the adjusted, declared value of the capital stock. The new rates are: 6 per cent of the portion of net income in excess of 10 per cent but not in excess of 15 per cent of the

[3] *The Revenue Act of 1935*, Public No. 407, 74th Congress, First Session (H.R. 8974). For a review of the various alternative proposals and a summary of revenue estimates, cf. R. G. and G. C. Blakey, "Revenue Act of 1935," *American Economic Review*, XXV, 673-690 (December, 1935).

value of the stock; and 12 per cent of the portion in excess of 15 per cent of such value.

5. The rates were increased and the brackets were extended, in the additional tax on the undistributed, adjusted net income of personal holding companies. The new rates range from 20 per cent of the first $2,000 to 60 per cent of any amount of net income in excess of $1,000,000.

6. Estate tax rates were raised and the rate brackets were extended to carry the progression to higher levels. The new rates begin at 2 per cent of the net estate not in excess of $10,000, and rise to 70 per cent of that portion of the net estate in excess of $50,000,000. It should be said that all of the successive estate tax changes since the Act of 1926 have been, in turn, superimposed upon the rate structure of that Act. A credit is allowed for state inheritance taxes equivalent to 80 per cent of the tax imposed by the 1926 Act. This credit is not permitted against the subsequent additional federal levies. In the case of persons dying after the effective date of the 1935 Act, executors were given the privilege of electing to have the value of the gross estate established as of the date one year after death, instead of as of the date of death.

7. Relative increases were made in the gift tax rates. This tax uses the same brackets as the estate tax, but the rates have always been about 25 per cent lower.

Some minor changes and administrative adjustments were also made.

This series of changes, presented here in brief outline, should be considered first as fiscal measures, and second, as a response to the arguments and reasons set forth in the President's message demanding them. It is evident that Congress went further in some directions than the message had proposed, while it substituted heavier taxes on estates and gifts for the additional taxes on inheritances and gifts which were requested.

The first striking fact encountered, in considering the Act of 1935 as a fiscal measure, is the delay provided before almost all of the rate increases become effective. The increased rates on individual and corporate incomes, on personal holding companies and on gifts, apply first to the returns for taxable years beginning after December 31, 1935, which means that the first collections at the higher rates will be made in March, 1937, upon returns for the calendar year 1936. The capital stock tax is payable at the new rate for the year ending June 30, 1936, and the new excess-profits tax goes into effect for the income taxpayer's taxable year ending after the close of the first year in respect of which it is taxable at the increased rate on capital stock. The new estate tax rates are applicable to the estates of decedents dying after the effective date of the Act.

In view of the well-known disparity between revenues and expenditures this would be the more difficult to explain were it not for the fact that in submitting the budget for 1936, with its anticipated deficit of

$3,892,000,000, exclusive of provision for sinking fund or other debt repayment, the President had said that new or additional taxes were not contemplated. Evidently the revenue motive, the sense of obligation to diminish the gap between Treasury income and outgo, the need of hastening the day of a completely balanced budget, were not primary considerations, at either end of Pennsylvania Avenue, for the enactment of this measure.

A second generalization, which may illuminate somewhat the indifference as to when the rate increases were to become effective, is that the Act, once in operation, is not expected to add materially to the revenue. The estimates of yield for a full year's operation are as follows:[4]

ESTIMATE OF ADDITIONAL REVENUE
(for a full year of operation)

Source	*Yield of Conference Bill*
Surtax increases	$45,000,000
Graduated corporation income tax	37,000,000
Capital-stock tax	44,000,000
Excess-profits tax	10,000,000
Estate tax	80,000,000
Gift tax	21,000,000
Intercompany dividends tax	28,000,000
Total	$265,000,000
Corporate deduction for charitable gifts	15,000,000
Net total additional revenue	$250,000,000

This table omits reference to the tax on personal holding companies, possibly on the ground that the new rates will eliminate this device, and thus the prospect of tax yield from this source. In some cases padding of the estimates may be suspected, unless it be said that liberal allowance has been made for economic recovery in the near future.

Assuming that the new law will consistently produce $250,000,000 of additional revenue, this sum must be put into the balance against the volume of deficiency operation that has been experienced for some years. When this is done the Act of 1935 must be appraised as a feeble attack on the federal revenue problem. What can be said of it as a contribution to federal tax policy? Does it correct or magnify former characteristic defects?

In order to deal with this question, it will be necessary first to comment briefly on certain fundamentals of the federal tax scheme. The income taxes, together with the capital stock and profits taxes, may be regarded as an attempt to establish a combination of personal and business taxation. It would be unfair to assert that Congress had ever consciously held this view, or that it had ever been seriously influenced by the motive of achieving a proper balance among the different elements. Furthermore, no one has ever attempted to formulate a theory of personal and business taxation for the federal government. This has been done for the states, however, by the National Tax Association, and it is reasonable to assume that a theory and

[4] "Conference Report on the Revenue Bill of 1935," in *Congressional Record*, August 24, 1935, pp. 14863, 14864.

policy of personal and business taxation would be as appropriate and as applicable for the federal government as it is expected to be for the states. The essentials of the system of personal and business taxation which is set out in the Association's "Model System of State and Local Taxation" will be summarized briefly in order to provide a basis for testing the federal policy and the effects of the 1935 legislation.[5]

The position taken in the model plan with respect to the characteristics of personal and business taxation, when the two methods are to be coordinated in a system of taxation, is as follows:

Personal taxation should be devised in accordance with ability to pay. Net income is approved as the best test or measure of ability, and there should be, therefore, a personal income tax, so constructed as to accomplish the following:

1. To apply to every person having taxable capacity;
2. To tax the entire net income of every resident from every source;
3. To levy the tax at progressive rates; and
4. To permit only moderate personal exemptions or credits against net income in computing the tax.

Business taxation should be devised in accordance with the benefits which government confers upon business conducted within its jurisdiction. In order to promote uniformity of procedure in the choice of a base upon which to tax business according to benefits, the net income from the business done was recommended as the base. The states must allocate net income among themselves, but the federal government would find this necessary only in the case of concerns doing business internationally. The essentials of a business tax on net income are a proportional tax rate and a moderate tax burden.

No criteria are suggested by which to determine what is a moderate tax rate or tax burden, but the viewpoint is that the proper place for heavy taxation is in the personal tax rather than in the business tax. Ability is an attribute of persons and not of business units. Economic activity is intermediate, and the business unit is a conduit for the flow and distribution of income. Severe taxes on business are restrictive; they are a discouraging influence since they reduce the apparent profitableness of enterprise. Heavy taxation of personal incomes is less likely to have this effect, until it reaches a level that impairs consumption or the flow of investment funds, since it is not identifiable with any particular branch of enterprise.

Space does not permit more than a limited and hasty application of this general theory of the relationship between personal and business taxation to the federal situation.

[5] Cf., "Second Report of a Committee of the National Tax Association on a Plan of a Model System of State and Local Taxation," *Proceedings of the National Tax Association*, 1933, pp. 353-420.

In the first place, it is apparent that the federal law taxes business as such too heavily, and personal incomes, on the whole, too lightly, despite the latest increases in the surtax rates. This policy tends to defeat rather than promote the purpose set by the President for the prudent government, which is to "produce ample revenue without discouraging enterprise." Thus, the rate on corporation income has been high for years, and the recent increases mean that about one dollar in seven of net income will be taken in the federal tax. The graduation feature is contrary to all accepted principles of business taxation. It is, moreover, simply the camel's head inside the tent, and we may presently expect him inside on all fours if this practice is not resisted. The double taxation of that portion of intercompany dividends not deductible is an added, though indirect, burden.

The capital stock tax is simply a device to get revenue without much regard to how it is obtained, and there can be no explanation of the excess-profits tax except as a means of impaling the corporation more securely on the capital-stock-tax horn of the dilemma. Both taxes are unreal. The declared value of capital stock need have no relation whatever to the actual value of the stock or the capital assets. The concept of excess profit can have only an artificial and arbitrary meaning unless it is related to the invested capital that produces the income. Yet the basis for measuring excess profit is the declared stock value, which may be any amount whatever. The whole scheme is simply a squeezing device. It is anomalous, to say the least, to find an excess-profit tax in the National Industrial Recovery Act, which begins with a picture of a national emergency and calamity that might have been written by Jeremiah; and to find also that concurrently with enormous expenditures to restore confidence, stimulate private enterprise, and promote economic recovery, there should be imposed a tax on excess-profit. Scattered instances of profits that were abnormal in relation to invested capital there may have been, even in 1933, but the phenomenon of excessive profits accruing to business in general after all that had occurred since 1929 could exist only in a seriously disordered imagination. Enterprise as such and the whole country need the stimulation that would come from rising profits. As a recovery tonic it is vastly superior to any substitute therefor that the government can offer. An excess profits tax during a severe economic depression is at once an ungracious and a ridiculous gesture.

There need be no concern, if the business tax were less heavy, that corporate earnings would be accumulated rather than distributed in order to protect large stockholders against severe taxation. The taxes now levied on personal holding companies should rather effectively dispose of the "incorporated pocketbook." Further, if the rate on corporation income were reduced, there would be a better case for a tax on undistributed earnings. A committee of the National Tax Association urged this arrange-

ment, in connection with more moderate taxation of corporate income, in 1927.[6]

If the 1935 legislation has tended to overload still further the business taxation feature of the federal tax system, can it be said that the changes in the individual income surtax rates constitute adequate counterbalance? The answer must be in the negative, despite these changes, which apply only to incomes above $50,000. The fact is that only a small number of taxpayers, and only a small part of the reported net income, are involved. Had the new surtax rates been effective for returns made in 1933 and 1934, they would have applied to only 7738 persons filing returns in 1933 and to 7974 persons reporting in 1934. The total amount of net income reported by those who would have been affected was $773,692,000 in 1933 and $837,770,000 in 1934. This is not an argument against the rate increases of 1935; but it must be plain that more than this must be done with the personal side of the income tax. Severe as the 1935 rate increases were, they are estimated to produce only $45,000,000 additional revenue. The total net income in amounts above $50,000 was about 7 per cent of the total net income reported in 1933, and about 8.5 per cent of the total net income reported in 1934. A demand that more taxes be collected from the wealthy makes a strong popular appeal, but the additional revenue in sight is not impressive. If all incomes above $50,000 were appropriated outright it would not make much impression on the federal deficit. The Act of 1935 was not a serious effort to improve the personal income tax. It left untouched the problem of normal and surtax rates, the liberal personal credits, and the comparative unproductivity of the rate schedule in the middle and lower brackets. An amendment which reaches only about 2 per cent of the individuals making returns, 8 per cent or less of the net income reported by individuals, and has the prospect of producing a mere driblet of additional revenue, must be regarded as tinkering with, rather than revision of, the law.

The Case for the 1935 Tax Program

Since the 1935 Revenue Act is so unsatisfactory as an amendment of the federal revenue program and as a contribution to a more adequate federal revenue policy, it becomes necessary to examine the document which was primarily responsible for this legislation in order to discover the reasons for these shortcomings. The message of June 19 may be considered, first, from the standpoint of its financial argument, and second, from the standpoint of its broad purpose and objective, which are clearly other than financial.

Following the opening paragraphs already quoted, the principle of

[6] Cf., "Committee Report on Simplification of the Income Tax," in *Proceedings of the National Tax Association*, 1927, pp. 133-135.

ability is announced as the governing principle of federal taxation. There is some evidence of confusion regarding the distinction between taxation according to ability and according to benefits, and an erroneous, though possibly inadvertent, characterization of the federal income tax as being levied in proportion to ability. But both ability and benefit are lost sight of in stating the case for the additional inheritance and gift taxes, and for the increase in the higher surtax rates. Needless to say, there is no emphasis, scarcely even mention, of the Treasury situation.

The argument shifts to the evils of vast inheritance and large incomes, and their disturbing effects on the national life. But the inheritance tax proposal was extremely indefinite—too indefinite, apparently, for Congress. This tax was recommended "in respect to all very large amounts received by any one legatee or beneficiary." There is no indication as to what should be considered a "very large amount," and consequently no criterion proposed by which to determine the maximum inheritance which would have no disturbing effect. No practical consideration is given to the immense difficulties involved in dealing with the great variety of conditional and contingent interests that may be created in the division of an estate among the beneficiaries. Nor is there any recognition of the fact that the states, with but one exception, are taxing either inheritances or estates.

In discussing the income tax, the emphasis was likewise placed upon social unrest and the need of eliminating it by rigorous methods, rather than upon personal ability and the need for revenue. Had the ability principle been consistently applied, it should have been apparent that there is a vast zone of taxable ability lying below and above the present levels of exempt income as well as in the highest brackets.

The discussion of surtax rates is only partially correct and the effect is misleading rather than informing. The following passage was written to illustrate the proposition that the disturbing effects of great inheritances on the national life can be reduced through a definite increase in the rates now levied on very great individual incomes:

> To illustrate: The application of the principle of a graduated tax now stops at $1,000,000 of annual income. In other words, while the rate for a man with a $6,000 income is double the rate for a man with $4,000, a man having $5,000,000 annual income pays at the same rate as one whose income is $1,000,000.

Two difficulties are involved, one of which is practical and the other mathematical. As long as there are two types of tax rate, normal and surtax, there will be sharp distinction between those who just escape surtax and those with slightly larger net incomes who must pay it on a portion of their income. This inequality can be eliminated by abandoning the double rate system and starting the progression from the bottom. At the other end of the scale the difficulty is mathematical, for there must be

some level of income beyond which the rate becomes proportional, unless it is eventually to reach 100 per cent of all income above a fixed amount. Tax rate progression cannot conveniently rise above 100 per cent.

The statement quoted not only ignores these elementary considerations, but it is not accurate as it stands. Under the 1934 Act, the tax on $4,000 of net income is $160, and on $6,000 it is $320. The surtax scale begins at $4,000, and the rate is doubled, as it happens, only for the excess of income above $4,000. Consequently the equivalent rate of tax on the entire $6,000 income is 5.33 per cent, and not 8 per cent as is implied. Likewise, at the other end of the scale, the effect of progression to a certain level with proportion beyond that level is a slowly rising equivalent tax rate as the total income increases. The man with $5,000,000 pays at a higher equivalent rate on his entire income than the man with $1,000,000.

In the discussion of the corporation tax, the argument, wittingly or otherwise, is a benefit argument, but the conclusion and recommendation jump over the ability principle. It is said that the advantages and protections conferred by government increase with size, and again, that as the profits of a corporation increase, so the value of its advantages and protections from government increases. This is familiar argument, but it leads to uniform or proportional taxation of business. Nothing is said to indicate a belief that the value of the benefits increases faster than profits. But the conclusion is that the tax system should be adjusted to "economic capacity, advantage, and fact," and since the graduated principle is now operative with respect to personal incomes, estates, and gifts, it should also apply to corporations.

The reference to economic capacity reveals that ability is being imputed to business units. No argument should be needed to establish that ability is a personal attribute, or that the ability of a corporation exists only as the respective abilities of the several shareholders. It is said that today the smallest corporation pays the same rate on its net profits as the corporation a thousand times its size; but it is not pointed out that the small concern pays only one-thousandth as much tax. If the stock distribution of the large corporation is at all typical, there may be greater ability in the few shareholders of a small concern, as individuals, than in the average shareholder of a large concern.

The Redistribution of Wealth through Taxation

The purpose back of the kind of tax legislation requested and the motive in requesting it are rather frankly admitted to be the redistribution of wealth through severe taxation of large estates and large incomes. No group is better qualified than the members of this Association for sober consideration of the problem of wealth distribution, but this subject, in itself, is beyond the scope of the present paper. The proposal to use the

taxing power deliberately as an instrument for achieving a different distribution than now prevails is germane; while its discussion here must be cursory, the subject cannot be entirely neglected.

Opposition to such a policy commits one neither to a defense of the existing scheme of distribution, nor to opposition against any concrete goal of redistribution. It means simply that the taxing power is regarded as both inappropriate and relatively ineffective for the purpose desired.

Taxation designed expressly to achieve a redistribution of wealth is inappropriate because it is inconsistent with the nature and purpose of the taxing power as now defined and understood. A distinction must be made between the incidental and indirect effects upon the distribution of wealth, and the deliberate exercise of the taxing power to equalize distribution. Every tax payment diminishes private income or wealth, and progressive rates obviously produce greater results in this direction in the case of large than of small incomes or estates. The use of progression, when it is logically applicable, can be defended from a revenue standpoint, however, on the basis of relative abilities to contribute to the support of government, notwithstanding the leveling-off effects of this type of tax rate. The government's essential purpose is to derive revenue from its subjects in the manner most in accord with their respective abilities to contribute.

This, according to all modern statements of the tax concept, is its primary and fundamental purpose. Economists and statesmen have labored for centuries to develop canons or principles governing the exercise of the taxing power in the quest for revenue, and to determine the bases according to which the subjects should contribute. The object of these canons is primarily the avoidance of discrimination in taxation. It must be admitted that more than one instance of taxation can be cited in which the purpose has been regulation, control of the direction or the character of business activity, or some other purpose than the provision of revenue. Virtually none of these instances can successfully meet the acid test of proper taxation, although some of them have received the sanction of the Supreme Court, which has usually ignored the ulterior purpose and accepted the bare declaration of revenue intent. Unfortunately, the Court does not always look through the form to the substance.

Deliberate taxation to redistribute wealth necessarily involves relative disregard of established principles of fairness and equity. It is necessarily and intentionally discriminatory. A campaign to redistribute wealth through oppressive taxation must begin with the very wealthy; but it is entirely capable of arriving, before the finish, at the kind of wholesale expropriation known as "liquidation" in Russia and "race purification" in Germany. When a government discards the essential principles that have been built up to control and regulate the exercise of this great power in its

legitimate function of providing revenue, there is no chart, no compass, no haven, for there is no necessary or logical stopping place short of complete equalization. Today an income of $5,000,000 or an estate of $50,000,000 seems too large for the common good; tomorrow an income of $5,000 or an estate of $50,000 may loom up as a disturbing influence in the social life. More than this, there is no assurance that in the leveling-off process, other types of minority than the plutocratic type will not be singled out. Once the tremendous power of taxation is unloosed, to be exercised in discriminatory fashion, it is capable of becoming a powerful instrument for the suppression of any minority group which is out of favor. Such abuses may seem remote and unlikely now; but when discrimination becomes the keynote of taxation, they will not be far off.

The proposal to redistribute wealth through taxation is made, in the document under discussion, with the most superficial consideration of its economic and social effects. It is asserted that severe estate taxation does not affect the essential benefits that remain after the death of the creator of a large business. Then comes the following:

> A tax upon inherited economic power is a tax upon static wealth, not upon that dynamic wealth which makes for the healthy diffusion of economic good.

The classification of wealth into static and dynamic forms is an original contribution to the terminology of economics, and the dictum regarding the effects of estate taxation on the two forms is an original contribution to both economics and finance. Does this mean that large accumulations are static, while small holdings are dynamic? If so, it should be contrasted with the following passage:

> In the modern world, scientific invention and mass production have brought many things within the reach of the average man which in an earlier age were available to few. . . . The community has profited in those cases in which large-scale production has resulted in substantial economies and lower prices.

It is obviously believed that the heavy taxes asked for can be paid without material interruption to business activity or the volume of production. The Bureau of Internal Revenue evidently takes a different view of the existing estate tax, for, in the discretion of the Commissioner, it permits extended periods of payment up to eight years in order to avoid disruption of going concerns. Mr. L. H. Parker, chief of staff for the Joint Committee on Taxation, suggested that twelve years be allowed for payment under the new rates, although this would largely defeat the objective of redistribution aimed at by the President, for it would more nearly enable the heir to meet the tax out of income or by borrowing, and thus to preserve the estate intact. Mr. Parker was urged to say what would be the effect of the new taxes on employment, on initiative, and on business activity, but he would only reply, "It is a very troublesome question."[7]

[7] "Proposed Taxation of Individual and Corporate Incomes, Inheritances and Gifts,"

Taxation is ineffective as well as inappropriate. No one has studied the possible effects of drastic estate taxation that is not commuted through administrative leniency into special, heavy income taxation, nor has anyone considered concretely the mechanism of redistribution sought to be accomplished in this way. The tax could be paid in money or in kind. If in money, without prolonged delay, there must be liquidation of assets or titles. The public would get in on some good things, but liquidation would not scatter the shares of the Ford Motor Company, for instance, widely enough to check any social unrest that is being stirred up. The rank and file of citizens could share in the redistribution results only through large government spending, some part of which would take the form of doles and reliefs to those affected by any resulting break-up of business organization and operation. While the redistribution process and revenues continued, the "bread and circuses" could be financed thus, but it would eventually require mass taxation to provide them.

If the tax were payable in kind, the government would presently be a majority stockholder in various large industrial enterprises. Whether this would mean, in the long run, more and cheaper Fords or Plymouths, is at least an open question.

The demand that wealth be redistributed is usually based on the charge that certain features of the economic order operate to the advantage of a few. But severe taxation of large estates and large incomes occurs after the fact; it does not prevent exploitation if there be such. Rather, it puts government into closer association with the exploiter for the sake of the revenue. The complete confiscation of a large estate at the death of its accumulator does not mean restitution to those from whom the fortune may have been wrung. It is cold comfort for the present generation to be assured that when the rich men die their goods will be taken by the government. Taxation looks like a sure and easy way; in reality, it is the least effective way, and its advocacy indicates failure to perceive the real character of the abuses, if such there be, that make possible large wealth accumulation, or lack of political and moral courage to deal with these abuses more directly.

It is therefore unfortunate that this message did not outline a real improvement in the federal tax program and a substantial broadening of the tax base, simply and frankly on the ground that the budget was in a bad way, that expenditures were larger than could be met except by inflation of credit and currency, and that it was time for the American people to get on a pay-as-you-go basis, both for ordinary and emergency expenditures. Such a tax program would have deserved and would have had our support and our respect.

Hearings before the Committee on Ways and Means, House of Representatives, 74th Congress, pp. 32, 33.

RELATIONS BETWEEN FEDERAL, STATE, AND LOCAL FINANCES

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The recent outburst of public interest in the relations between federal, state, and local finances is obviously a product of the welter of new tax legislation which has been enacted during the last few years. Although similar flares of interest in the past have not generally led to very substantial results, the present movement may prove an exception. It is significant, at any rate, that a number of investigating bodies, both official and unofficial, have lately been subjecting our intergovernmental fiscal arrangements to critical scrutiny. Moreover, President Roosevelt has indicated his intention of calling a conference on the subject within the coming year. Back of this new concern over the financial relations of our various levels of goverment is, of course, a growing conviction that these relations have much to do with our current fiscal woes.

Outstanding among the characteristics of our system of intergovernmental fiscal arrangements is the unusual extent to which we rely upon local taxation in supporting our public functions. As is well known we have in the United States some 175,000 units of local government, comprising municipalities, counties, townships, and special districts. These local governmental units, despite their smallness of area, normally collect over half of all our taxes. In no other modern country, not excluding those which, like our own, have a federal form of government, do local taxes represent as high a proportion of the combined tax collections of all levels of government as is the case in the United States. Associated with our heavy reliance upon local taxation is the comparatively limited use which we make of national taxes in financing our various governmental needs. Here again the United States occupies a unique position. In no other important industrial country is the ratio of national to total tax collections as low as is our own.

Another characteristic which distinguishes our intergovernmental fiscal relations is the extent to which each of our many governmental units is free to frame its own taxing program without reference to what other jurisdictions may be doing along the same line. Except for a few constitutional restrictions, the federal government and the states are at liberty to impose practically any taxes they choose. The taxing powers of municipalities and other subdivisions of states are subject to legislative prescription but occasionally, as in the case of New York City, the powers given them are extremely broad. In the absence of any central co-ordinating authority, we find wide differences in the respective taxing systems of the several states. In numerous instances we find duplicate administration of

allocated among the various states in which they own property or conduct

the same types of taxes by both the federal government and the states. It is even possible to find taxes which are being independently administered by three or more grades of government.

The characteristic features of our present fiscal order are doubtless a product of our special history. They bear witness to the high value which Americans have always placed on the principle of local self-government. But the economic environment of today is vastly different from the one in which these features took form. Under modern conditions, it is becoming increasingly difficult to support public functions adequately and to distribute their costs equitably and efficiently on the basis of a multiplicity of independent and semi-independent taxing jurisdictions, whose areas are for the most part small.

One difficulty arises from the uneven geographical distribution of wealth and income which comes with economic specialization and the growth of cities. This unevenness makes for wide inequalities in the respective abilities of small governmental units to supply public services. The mobility of economic activities and the impossibilty of confining them within narrow political boundaries give rise to a host of other difficulties which limit our ability to spread the costs of government in a fair and efficient way.

Under modern conditions, as has frequently been pointed out, the smaller the area of a taxing unit, the more limited is the range of taxes which it is in a position to administer effectively. Altogether apart from legal restrictions, the only form of taxation from which local governments are likely to secure much revenue is the tax on real estate. Real estate cannot be moved, but most other subjects of taxation are too active and elusive to be caught in the small tax nets which municipalities, counties, and districts are able to spread.

State governments by virtue of their wider areas have a broader range of taxes at their disposal, but even they are subject to handicaps which the federal government escapes. One of these handicaps is interstate tax competition which limits the ability of a state to tax wealth and income which is not tied down to a fixed location. A second handicap is competition with the federal government. Since the states and the federal government are to a considerable extent employing the same types of taxes, state fiscal officials may sometimes find their budgetary calculations upset by emergency changes in the federal taxing program. A third handicap is the tax immunity accorded interstate transactions under the Interstate Commerce Clause. This makes it difficult for the states to employ certain kinds of taxes, notably taxes on sales, without subjecting their own citizens to a competitive disadvantage. A final handicap grows out of the large proportion of our business activities which transcends state lines. This complicates the task of state tax administration, since it means that the taxable assets and income of interstate business enterprises must be artificially

allocated among the various states in which they own property or conduct operations.

The difficulties which have just been enumerated are producing results which increasing numbers of people are unwilling to accept. These results may conveniently be discussed from the standpoint of the various groups which find them objectionable. Foremost among these groups is the large class of citizens who are dissatisfied with the way our total tax burden is now being distributed. This group naturally contains as many subgroups as there are different views on how the tax burden ought to be distributed.

It has already been pointed out that our various grades of government are on a very unequal footing as regards the range of tax sources which each is in a position to exploit successfully. This means that the distribution of our local tax burden is to a large extent automatically determined by the way responsiblity for the support of public functions is divided as between federal, state, and local governments. Local governments are now responsible for raising over half of the funds needed to meet our governmental costs and since the general property tax is the only revenue source of any importance which the localities can count upon, this outworn tax continues to carry over half of our total tax load. It is now generally recognized that property tax relief requires a shift of financial responsibility from the localities upward to the states and to the nation. Only these latter grades of government have areas sufficiently large to permit them to secure considerable amounts of revenue from tax sources other than property. Prominent among the advocates of a change in our intergovernmental fiscal arrangements we accordingly find the owners of real estate.

Another group with a grievance against our present fiscal order are the payers of gasoline, cigarette, and liquor taxes. They object to the duplicate and triplicate levies to which they are being subjected under a system which permits two or more levels of government independently to utilize the same types of taxes. They claim that these multiple levies have raised the combined rates of taxation on their commodities beyond the point of maximum tax yield, and are demanding that the administration of the taxes in question be confined to a one level of government.

Again we have groups which are interested in placing a larger share of the total tax load upon one type of tax or another depending upon their individual tax philosophies. We have, for instance, the group which believes that we must secure a wider distribution of governmental costs, and that the best tax for this purpose is the sales tax. The new crop of retail sales taxes recently enacted by many of our states has revealed serious obstacles in the way of efficient state administration of this type of tax. Some sales tax proponents are, accordingly, proposing that the relations between federal and state finances be changed, at least to the extent of

scientific principles. It is not intended to make an exhaustive review of

permitting the states to share in the proceeds of a manufacturer's sales tax to be administered by the federal government.

Opposed to the sales tax group, is the group which would have a larger proportion of our public revenues raised through the income tax. As was pointed out by Professor Seligman a quarter of a century ago, the federal government is in a much better position to administer the income tax effectively than are the several states. Despite this fact, state income taxes have spread and are now in effect in about two-thirds of the states. In none of these states, however, has the income tax as yet been developed to the point of carrying more than a minor share of the total state and local tax load. Income tax partisans who would like to see this tax play as prominent a rôle in the United States as it does in Great Britain are beginning to doubt whether it will ever be possible to develop the full potentialities of the income tax under dual federal-state administration. They are accordingly coming back to the solution suggested by Professor Seligman in 1910; namely, that the federal government assume exclusive administration of the income tax with an accompanying adjustment of federal, state, and local financial responsibility.

But the list of those who are dissatisfied with the existing relations between federal, state, and local finances is by no means limited to those who are seeking a redistribution of the tax burden. It also includes groups who are interested in the more adequate and uniform support of one or another governmental function. Since local governments have far less ability to maintain adequate and uniform standards of public service than have the states and the nation, these groups would have the states and the nation assume a larger share of the costs of certain functions such as education and health which they conceive to be affected with a certain degree of state-wide and nation-wide interest.

Still other groups with other reasons for feeling dissatisfied with the workings of our present intergovernmental financial arrangements might be mentioned. These are, for instance, the groups which are interested in states rights, and the groups which are concerned mainly with the matter of economy and efficiency in tax administration. But enough examples have already been cited to make it reasonably clear that although sentiment for a new adjustment in the relations between federal, state, and local finance is growing, yet the objectives of those who desire a change are exceedingly diverse and in part conflicting. Notwithstanding this fact, the impression seems to have gained some prevalence that it will be possible to solve our present difficulties in a rational and objective way on the basis of a new set of fiscal specifications to be scientifically arrived at by experts. Analysis of the solutions currently offered, however, would seem to indicate that there are issues at stake which cannot be settled on the basis of

scientific principles. It is not intended to make an exhaustive review of the proposed solutions but a few of them may be mentioned for the purpose of illustration.

One popular remedy is segregation, which involves assigning to each level of government a specific group of taxes for the exclusive use of that level. A proposal along this line, editorially sponsored by an influential metropolitan newspaper, contemplates giving sales taxes to the federal government, income taxes to the states, and real estate taxes to the localities. This solution would doubtless be satisfactory to those who believe that we should rely heavily on consumption taxes in spreading our governmental costs. The federal government is in a position to make the sales tax vastly more productive than are the several states. But to assign the income tax to the states would for all practical purposes amount to writing its death sentence since the states are obviously not as capable of developing the possibilities of this tax as is the federal government.

All segregation proposals involve two basic questions. First, what types of taxes shall we include on the list to be divided? Shall we or shall we not, for instance, include the general sales tax? The answer to this question depends, of course, on our social outlook and on the kind of tax system we wish to have. Second, on what basis shall the taxes included on our list be allocated? From the standpoint of economy and efficiency in tax administration, the rational procedure would be to assign to each grade of government the types of taxes which it is in the best position to administer effectively. But the carrying out of this principle would probably give the federal government an administrative monopoly of most of our more important non-property taxes, which would clearly not be compatible with segregation.

The principle of administrative efficiency would seem to require that the administration of most of the taxes now independently utilized by both the federal government and the states be centralized in the federal government. There are several varieties of centralization proposals. One of them involves the device of nationally-administered, state-shared taxes. The federal government is to assume the exclusive administration of certain types of taxes but is to turn a portion of the proceeds back to the states on the basis of origin of collections. A suggestion on this order which recently received considerable attention was that the federal government enact a manufacturer's sales tax the proceeds of which were to be shared with the states provided that the latter retired from the sales tax field.

In connection with this proposal, it may pertinently be asked: Why choose the sales tax and neglect income and inheritance taxes which from the standpoint of administrative efficiency are equally eligible for centralized federal administration?

Nationally-administered, state-shared taxes raise other questions which it is difficult to answer on purely rational grounds. At what rate shall the centrally-administered tax be fixed and what proportion of the proceeds shall the states receive? If revenue needs be accepted as the criterion, shall we consider the needs of the average state, of the neediest state, or of the least needy state?

Nationally-administered taxes apportioned among the states on the basis of origin of collections will not, of course, solve the problem raised by regional inequalities in the distribution of wealth and income. To meet this problem, we have various proposals involving federal subventions or grants-in-aid. These proposals assume that the federal government will have exclusive control over all types of taxes in respect of which it enjoys a marked administrative advantage and that it will share the proceeds of these taxes with the states and localities through grants to each unit based on some measure of need.

General or blanket grants subject to no restrictions as to the purpose and manner of their expenditure invite at least two queries. First, is it justifiable to use any part of the proceeds of national taxes to support functions and services which are of purely local concern? To be specific, should the income-tax payer in Massachusetts or California be asked to contribute toward the cost of an ornamental lighting system for a town in Arkansas? Second, regardless of the purposes for which the grants are used, is it wise to divorce the raising of taxes from control over their expenditure?

The questions which have just been raised do not, of course, apply to all subvention proposals. Thus the federal government might assume financial responsibility for the maintenance of minimum national standards in respect of particular functions which were conceived to be affected with a national interest. Administration of the functions in question would remain with the states and localities, but the federal government would bear or at least equalize the burden of maintaining its minimum standards, and would exercise sufficient supervision over the functions to see that its standards were enforced. Even this proposal, however, raises a question to which there is no scientific answer. What functions now carried on by the states and localities are affected with a national interest and how far does that interest extend?

A complete review of current proposals would, of course, include a discussion of the various suggestions for making further use of federal credits for state taxes, a device which has been employed for a number of years in the field of inheritance taxation. It would also include a discussion of state supplements or additions to federal taxes. These contrivances, however, while possessing advantages, have limited significance, since they leave some of the most serious problems growing out of the present fiscal situation untouched.

Enough questions have probably been raised to establish the point that the process of reaching a new adjustment in the relations between federal, state, and local finances involves issues which are outside of the sphere of the expert. But does the presence of issues which cannot be settled objectively mean that a new adjustment is impossible? Most decidedly not. As individuals we are constantly making subjective decisions and modern democracies have developed machinery and techniques for registering mass decisions of a similar kind. The process of reaching agreement will, of course, by facilitated if all of the issues at stake are frankly recognized. They should certainly not be allowed to hide behind a cloak of rationalizations.

What then are the issues which must be settled before we can formulate the details of a more modern scheme of national, state, and local finance? Specifications would seem to be needed on at least four points:

1. How do we wish our tax burden distributed? To what extent do we wish it distributed through taxes on incomes and inheritances? To what extent through taxes on consumption? What functions do we wish to finance through taxes based on ability, and what functions through taxes based on benefit? Specifications on this point must in the final analysis come from the public.

2. What are the degrees of national, state, and local interest in the functions and services which we wish to support from public funds? There is, of course, no scientific answer to this question but some sort of public mandate is necessary if we are to know in what proportions, if at all, functions are to be supported through uniform state-wide or nation-wide taxes.

3. What are the most efficient areas of administration for functions of more than local concern? Here is where we must call in the various technical experts. Their answers will tell us whether a function affected with a state-wide or nation-wide interest should be directly administered by the state or nation, or whether the subsidy principle should be used.

4. What are the most efficient areas of administration in respect of each of the various types of taxes which we propose to use in our system? Which of these taxes in view of the sources from which they are drawn are most suitable for the satisfaction of local, state, and national needs respectively? For specifications on these last points we may look to the experts on tax administration and to the economists.

If the issues have been correctly stated, it would appear that a comprehensive readjustment in the relations between federal, state, and local finances will require the co-operation of those who are skilled in interpreting what the public wants, or at least what its legislative representatives will ratify, and those who are technically expert in the various fields of public administration. Have we now any agency through which these various

groups may be brought together and set to work on the problem at hand? Apparently what is needed is some sort of commission composed of legislative leaders, administrators familiar with the technical aspects of various governmental functions, tax officials, and economists. Such a commission might well be set up as a permanent agency, since in a highly dynamic world fiscal plans must be continuously modified to meet changing conditions.

A commission of the kind suggested would not in any sense constitute a supergovernment. Its duties would be purely planning and advisory. It would perform the same function for the country at large as federal, state, and municipal budget-making bodies now perform for their respective governments. Briefly, it would formulate a master plan of federal, state, and local finance, and on the basis of that plan would submit to Congress and to the legislatures of the several states recommendations and advice as to specific legislative measures.

The proposed commission might be set up as an agency of the President or of Congress. To emphasize its intergovernmental character, however, it might be expedient to establish it through reciprocal federal-state legislation. Whatever the procedure used, the creation of a commission on intergovernmental fiscal relations would seem to represent a necessary first step in the direction of securing a better adjustment in the relations between federal, state, and local finances.

EQUALIZATION OF LOCAL GOVERNMENT RESOURCES IN GERMANY AND ENGLAND

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The tendency for central governments to take over an ever increasing share of the tax resources of the country has been greatly accelerated during the post-War period in European countries. War and depression have increased the burden of taxation on the one hand while undermining the tax base on the other. The inevitable consequence has been the centralization of most of the important taxes. Only through uniform taxes and unified administration could governments hope to make ends meet.

This centralization of tax administration has not been accompanied by any corresponding centralization of other governmental functions. As a result the transfer of large sums of money from central to local treasuries was demanded, in order to maintain the solvency of local governments; and transfers have taken place on such a large scale that many local governments are receiving the major part of their support from the central governments.

It has been taken for granted that if taxes are better administered by central governments, and roads and schools and relief are better administered by local governments, the mere unbalancing of budgets which results should not be allowed to interfere with such a division of duties. The transfer of tax receipts, by one means or another, is a generally accepted practice after all. The difficulties are recognized, of course; but the tendency to waste when spending other people's money can be checked by adequate controls; and the danger that revenues will not match expenditures can be averted by equalization. It is in connection with this latter problem that I am going to discuss the post-War experience of Germany and England with central support of local governments.

Before the War the Reich made no contribution to state and local revenues. On the contrary it levied on the states for its own support. With the Weimar Constitution, however, the federal government's tax powers were greatly strengthened, and taxes formerly in the hands of state and local governments, notably the income tax, were appropriated by the Reich. In compensation substantial shares of these taxes were returned to the jurisdictions from whence they came. The identity of the individual taxes was retained and no restrictions were placed on their use. In the case of the income tax, which was as important in pre-War state and local finance in Germany as the general property tax has been in state and local finance in this country, 75 per cent of the yield (and for a time 90 per cent of the yield) was returned to the underlying governments. Little thought was given to the problem of equalization. Taxes were to be returned to the state, and even the commune, of origin. The only important deviation

from this rule was that all jurisdictions were to be guaranteed their former income as far as practicable. Since compensation for lost taxes was the primary consideration in distributing these revenues, no other course would have been politically feasible.

The shortcomings of this apparently simple and acceptable system of distribution proved to be very great. It was at once clear that taxes could not be returned to the commune where collected. The small size of the commune resulted, not infrequently, in a manufacturing establishment being located in one commune, the owner residing in another, and the workers living in a third. To return the corporation tax to the commune where the plant was situated and the personal income tax to the commune where the owner resided was in each case unsatisfactory to the communes concerned. It created an impossible situation for the workers' commune, since it is just such communes that bear the brunt of the cost of relief, education, and health activities; and under such a distribution the workers' commune would share in neither tax. Nearly one-fourth of the workers in Germany work in one commune and live in another. Origin, consequently, has been determined by elaborate formulas, which vary with the kind of business, the form of organization, and the tax schedule, and which are changed from time to time to meet changing demand.

A second shortcoming arises from returning to each locality a fixed proportion of the yield of a tax levied at a uniform rate. When such tax distributions form a small part of local income there is ample opportunity for adjustments in the rest of the system. As soon, however, as these tax distributions become the mainstay of local treasuries difficulties appear. The wide variations in local tax rates, which are one of the principal reasons for transferring a tax from local to central administration, arise from the fact that local resources do not match local needs, and local governments have exploited their resources in widely varying degrees. Central administration brings uniformity in the tax rate, but to return the yield of a uniform tax to the communities from which it comes precludes the adaptation of revenues to needs. With such a distribution the former low-tax communities obtain more income than they can spend economically, while the former high-tax communities are left with wholly inadequate income.

This situation was aggravated rather than helped in Germany by the guarantees of previous income. Ten years of war and inflation, with the attendant losses in territory and wealth, had brought radical changes in the economic system, and pre-War governmental standards bore little relation to post-inflation needs.

At first the German states and cities found their income greatly enhanced by the new system. The Reich was generous in sharing its newly acquired income, partly, perhaps, because it was not yet sure of its new power; partly, doubtless, because anything it denied the states and cities would

apparently be swallowed up in reparations payments. A brief period of municipal extravagance ensued quite foreign to the usual thrifty practices of German local governments. With the tightening of Reich control, and even more with declining tax yields, this municipal affluence gave way to municipal deficits and threatened insolvency, likewise unparalleled in modern German experience. In 1928-29 the state and local governments were receiving 47.2 per cent of their income from federal sources. In 1933-34 this had declined to 41.4 per cent although meanwhile local resources had shrunk materially, and local needs had expanded, since the bulk of the welfare burden had been left with local governments.

The only thing that has made this adjustment possible has been the virtual abandonment of the attempt to return taxes to the community of origin and the substitution of a redistribution of revenues in proportion to need. In 1928-29 more than four-fifths (83 per cent) of the state and local share in Reich revenues was returned to the states of origin. In 1932-33 less than half (46.1 per cent) of the state and local share was returned, even nominally, to the place of origin. None of the proceeds of the succession of emergency income taxes has been shared as such with the underlying governments. Instead, the municipalities have received a direct subvention from the Reich based on the number and proportion of the population on relief.

Other minor adjustments which cannot be considered here have contributed to the same end; viz., the equalization of resources. Of more interest than these is the equalization not contemplated in the law that has in fact been achieved through the distribution of personal and corporation income taxes to the community of origin. The actual allocation of these taxes has regularly been delayed by the time and labor involved in determining the share of each of more than 60,000 communes, and no attempt has ever been made to revise this base annually. In recent years, however, this revision has been deliberately delayed, because it has been found that the 1929 prosperity base brings larger returns to the industrial cities, with the most acute unemployment problems, than would accrue to them from distributions based on a later depression year; whereas states with a more balanced economy, based on agriculture and small manufactures, which have weathered depression almost untouched, would profit from revision. Thus administrators have deliberately—and wisely—ignored the intention of the law and achieved a temporary equalization in spite of it.

In addition to these Reich measures the erstwhile states have achieved material equalization among their constituent communes where the Reich has failed to do so, both through the redistribution of Reich taxes to the municipalities on equalizing bases and through the use of grants-in-aid. These state provisions have probably contributed more than have the Reich provisions for distribution, to the satisfactory working of the financial system. Among the many experiments which the states have tried, one in partic-

ular is worthy of mention. Nearly every state has established an equalization fund which is distributed among local governments on special equalizing bases. In a number of states all or a part of this fund is distributed at the discretion of state officials on the basis of proved need. Thus it is recognized that no formula will fit all cases. Need is a complex of many causes which no simple formula will measure; and a badly fitting formula, giving well-to-do communities unneeded funds while leaving poor communities practically insolvent, is a luxury that some of the states have felt they cannot afford.

Notwithstanding all these measures neither the Reich nor local governments have accepted equalization as a fundamental obligation of the Reich. On the contrary, equalization is regarded as an emergency provision to be abandoned as soon as conditions permit. In its place the local governments still hope to regain the right of imposing variable local rates on the Reich income tax. This the Reich has frequently promised them, but it is scarcely compatible with the highly centralized state which is the goal of the present régime. It seems probable that the ultimate solution toward which the Reich is working is further centralization of hitherto local functions.

The recent drastic revision of the fiscal relations of central and local governments in England was motivated by quite different considerations from those which instituted the German reform. The need for a uniform tax system did not exist. All the taxes except the local rates were already in the hands of the central government and a well-established system of grants-in-aid supplied local governments with more than one-third of their income.

The primary purpose of the Local Government Act of 1929 was derating. The Conservative government, as a recovery measure, exempted from local rates all agricultural land (such land had already been largely derated) and three-fourths of the value of industrial and transport property. The result was a material reduction in the local tax base. Compensation was in order and was generously provided. The new block grant exceeded the total estimated loss by a substantial sum, and every community was guaranteed its former revenue from derated property and discontinued grants for a limited period.

The block grant was not designed, however, merely as compensation for losses. On the contrary it marks a complete change in attitude toward the purpose of grants-in-aid. The grant-in-aid as a device for stimulating local governments to provide more and better services is essentially a British invention, although it has been extensively copied in this country. Equalizing grants were not unknown in England prior to 1929. The education grant carried with it certain equalizing provisions. But equalization was a subordinate factor even here. The minimum 50 per cent of approved expenditure accounted for the largest part of the education distributions, and most of the grants for other purposes were purely percentage grants.

The new block grant replaced a large number of the former percentage grants for specific functions. It is distributed according to an elaborate equalizing formula, which weights the population for the proportion of children under five years of age, the proportion of unemployed, sparsity of population, and low rateable values. The formula is frankly empirical. No scientific qualities are claimed for it. Actual tests, based on the status of the communities at the time the change was made, indicated that a distribution on this base would approximate needs more closely than a distribution on any other base proposed. It is interesting to note that the formula was chosen to fit a preconceived idea of need. But when some of those concerned with devising the formula were asked why they should resort to a formula when they knew what the actual local needs were, they replied that administrative discretion was not desirable. In their opinion, requiring local authorities to prove need would pauperize local governments on the one hand and place unnecessary labor and responsibility on central government officials on the other hand. This attitude is in marked contrast to that in Germany where requiring local officials to prove need is an established and growing practice.

Equalization of tax burdens was further promoted by the Local Government Act of 1929 through widening the area of charge for both highways and public assistance. While the direct support of these functions remained largely with local governments the wider area of support ironed out many of the inequalities in local resources.

The effectiveness of the particular formula selected for the block grant will probably never be fully tested. Temporary guarantees and other transition measures prevent the new system from going completely into effect until 1947. The government was, perhaps, overcautious in providing for gradual change. Meanwhile other developments may demand other solutions. There is already evidence that the proportion of children under five years of age in the population is going to be a less satisfactory measure of poverty in the future. In the short space of time between the first and second fixed grant periods, the declining birth rate decreased the importance of this factor in the formula by one-fourth (from 24 to 18 per cent). Moreover the decrease was greatest in the poorest communities. The younger workers are migrating from depressed to prosperous areas, and taking the young children with them.

During the same short period the weighting for unemployment increased from 8 to 20 per cent. This factor was introduced because the public assistance burden had been left largely in local hands. This year the national government has taken over the administration of public assistance, together with a substantial share of the cost. Thus one of the principal reasons for putting the unemployment factor in the formula has disappeared, while the importance of the factor has risen from fifth to second place. This cannot be regarded as a criticism of the formula as long as the government

takes the position that when the present formula clearly fails to measure need a new formula will be devised. It makes it apparent, however, that the formula in question has no enduring merit as a measure of need for England or for any other country.

Another change in the English grant system has contributed more to immediate equalization than the limited application of the block grant formula. The 50 per cent minimum contribution to education expenditures has recently been abandoned. This simple change has converted the education grant, which is equal to two-thirds of the block grant in amount, from what was primarily a percentage grant to a strictly equalizing grant. Thus the principal aim of the English grant system has been changed from stimulation to equalization. The larger number of grants—some thirty in all—are still percentage grants. But the larger proportion of the money is distributed on some equalizing base.

The government is not wholly converted to the equalizing principle. A very substantial number of percentage grants have been retained, and a large number of both national and local government officials still look toward the further development of the percentage rather than the equalizing grant. Here, as in Germany, the increasing use of the equalizing base for the return of national revenue to loval governments has been forced by the necessity of administering a heavy tax burden with the utmost economy; and it has not been accepted as an ideal and permanent standard. There is little promise, however, either in these countries or in the United States, that the pressure of the tax burden which has brought equalization will be reduced in the immediate future. And as long as this pressure continues, equalization by one means or another must continue. Under these circumstances a formula which measures need with some degree of accuracy is of the greatest importance.

Neither Germany nor England has made any real progress in developing such a formula. Both have devised temporary measures to meet temporary conditions, although the English system is the more consistent of the two. It may well be that no formula can be devised which will even approximate accuracy in measuring local needs and ability. If this is the case equalization must be achieved in part, at least, in other ways. The other possibilities would seem to be the further centralization of government functions, whether highways or public assistance, the further widening of the area of local support, and at least a limited amount of administrative discretion on the part of the central government officials responsible for the distribution of funds to local governments. With the application of all of these measures combined, the financial problem involved can doubtless be solved. It is evident, however, that the solution of the financial problem will narrow the field of local independence very materially. In fact it would seem to be an open question whether the remnants of local self-government remaining will be worthy of the name.

DISCUSSION

Carl Shoup: As Professor Lutz so clearly demonstrated, the Revenue Act of 1935 cannot be regarded as a significant contribution toward the balancing of the federal budget. Discussion of the Act must therefore be carried on largely in terms of certain aspects that have important implications aside from the absolute amount of revenue involved. Two of these Professor Lutz has developed in a particularly stimulating manner. I refer to the question of business taxation versus personal taxation, and the question of redistribution of wealth through the taxing system.

The place that business taxation should occupy in the federal system is, indeed, as Professor Lutz has indicated, a matter that deserves much more thought than tax students have given it. Without attempting to develop fundamental issues, I should like to raise a question concerning the difference between the federal situation and the state situation. It may well be that the federal government has much less need of a business tax than the states, primarily because the importance of the nonresident owner is much less. Another difference arises from the fact that the federal law, in contrast to the state laws generally, has attempted to integrate the corporation tax with the personal income tax by exempting corporate dividends from the normal tax; that is, the federal corporation tax has been a tax that is more of a device for collection of part of the personal income tax at the source, than a business tax, in contrast, for instance, to New York State's corporation tax. In this connection, it should be noted that the spread between the normal tax (4 per cent) and the corporation tax (12.5-15 per cent) is deceptive. For wealthy taxpayers the spread almost disappears, in effect. If the investor does business through the corporate form, the surtax can be levied, of course, only on the earnings left after the corporate tax has been paid, whereas similarly favorable treatment under a partnership form (substituting now the normal 4 per cent for the corporation tax) is not allowed. This point and other technical points so complicate the situation as to add to the reasons for caution in transferring to the federal field the arguments admissible for state taxing systems, with respect to personal versus business taxation. Professor Lutz indicates a possible reason for abandoning the double rate sytem under the federal tax, but this device, or something similar to it, is needed to maintain as much as possible the present characteristics of the corporation income tax.

The issue of a redistribution of wealth raises some important questions of definition. Is it purely a matter of personal opinion as to whether direct and not merely incidental redistribution of wealth exists (or is intended to exist) under a given tax system? Or is it possible to set up standards by which the question will be answered with reasonable unanimity by skilled observers?

One possible test is the chief purpose of the framers of the law. Professor Lutz has indicated that this is one of the tests to be applied. Let it be supposed, however, that two taxing systems yield substantially the same results, the one important difference being in the language used in expressing the motives of those who designed the systems. If the matter never developed any further than this no one would be much concerned. Apparently, therefore, it is necessary to

turn to the results of the system to ascertain whether it should be classed as wealth redistributing. What kinds of results give one system, and what kinds the other? Is the steepness of the rate graduation one of the results to be observed? This does not seem to be a helpful test. No generally acceptable definition of redistribution has yet been framed in terms of steepness of graduation. If the absolute level reached by the highest rate is the test, the same difficulty arises. These questions do not deny all usefulness to such terms as "redistribution of wealth," "discriminatory," and "oppressive," but they do raise the question whether such terms must remain as highly subjective and expressive of purely personal opinion as the words "just" and "equitable."

As long as the type and amount of expenditure is not used as one of the tests, it may prove impossible to set up an even partly objective dividing line between wealth redistributing tax systems and other tax systems. The confused state of mind of the public at large on this issue and the importance that the matter is assuming in the newspapers and other sources of popular comment make it advisable for professional students of taxation to reach, if possible, some sort of agreement as to whether the matter is purely one of personal opinion or whether some criteria can be established without considering expenditures.

This discussion inevitably brings in the matter of non-fiscal purposes of taxation. Whatever each of us may think about the proper uses of taxation, there seems to be a growing necessity for the tax student to think in terms of non-fiscal proposals, because, in view of current trends, it appears that he, among others, will be called on to an increasing degree to say whether a certain non-fiscal aim can or cannot be achieved by a certain tax measure. His advice should be indispensable because of his knowledge of taxation technique, but in return he will have to broaden his field of research and seek constantly to think of a tax system as a multi-purpose tool, closely integrated with the entire economic machinery.

Professor Newcomer, in speaking of the adaptation of revenue to need, indicated that uniformity in one aspect of the complex federal-state fiscal relations necessarily implies nonuniformity in some other aspects. Professor Heer clearly pointed out the diversity of interests. In these respects, both papers have rendered a distinct service in reminding us that there can be no one solution that will be universally conceded to be the most satisfactory possible. Another check to easy optimism is found in the disturbing fact that the pattern is constantly tending to "freeze" in more and more detail and in a haphazard way. For example, two moderate-sized cities in West Virginia have in the past few months enacted a retail sales tax of 1 per cent. Local taxes from sources other than property may grow somewhat faster and in greater variety than we might think. The longer the delay in acting on the problem, the more ground is lost, since there tend to develop certain established interests that narrow the field of choice for a comprehensive plan. However, there is some reason for optimism in the fact that recent discussion has assisted greatly in clarifying the issues and in helping the various groups to find where their true interests lie so that the necessary compromises can be worked out on an intelligent basis.

James W. Martin: The addresses by Professors Lutz and Heer if considered together suggest an examination of the influence of 1935 legislation on federal-

state relationships in taxation. It is clearly impossible to study this situation comprehensively prior to more extensive experience with actual administration; and, even if that were available, it would be out of the question to report on the details in a brief paper such as this. In consequence, my remarks will be confined to a few general observations prompted by the legislation itself. It is not apparent from the official record that the Treasury, the House Committee on Ways and Means, or the Senate Committee on Finance gave sustained attention to federal-state problems involved.

The pay-roll taxes imposed under the old age benefit provision of the social security statute, effective in January, 1937, do not fall directly on a base subject to state taxation. However, there is considerable relationship betwen a pay-roll tax and an employee's income tax. There is still more direct relationship between the former and state consumption taxes of a general character. The pay-roll tax, if in the long run it falls on employees, as is presumed to be the case, will tend directly toward a diminution in the current purchasing power of workers. Since the equivalent of this and the employers' tax, however, will presumably be paid out to the aged, the long-run influence of the impost may be to spread labor purchasing power to more members of the community, rather than to concentrate it in the hands of employed workers.

The pay-roll tax on employers of eight or more persons, effective January 1, 1936, will apply to the same base as similar taxes already imposed in some of the states and in prospect in some others. This situation was brought about by the provision in Section 902 of the Social Security Act that not to exceed 90 per cent of the amount payable to the federal government could be credited against a state tax of similar character. Thus far, such levies have been imposed in ten states counting the District of Columbia. The situation is somewhat confused for employers by the fact that, as Congress presumably anticipated, some states have imposed heavier rates than the .9 per cent which can be credited against the federal excise. For example, in 1936 New Hampshire and New York imposed 1 per cent, whereas Utah and Washington imposed 3 and 2 per cent respectively. Not only do the rates vary, but also the definition of those liable to tax is different in the several states which have enacted legislation providing for unemployment benefits.

The technical changes in corporation income taxes effected by the Revenue Act of 1935 were not so extensive as greatly to influence the relationship between federal and state taxation. The rate changes, however, will alter the distribution of aggregate taxes payable to the federal government and the states combined. Also the graduation features will tend to enhance the inequitable effects of state graduation of corporation taxes already provided in a number of states. The maximum federal corporation tax plus the high-rate state taxes on large corporations will constitute an unprecedented corporation tax rate for these larger concerns. Increased rates on personal holding companies will doubtless tend to terminate a means of avoidance of both federal and state individual income taxes. It is probable that such legislation by state governments will be rendered unnecessary by the provisions of this new federal enactment.

The federal capital stock tax and the excess profits tax directly duplicate certain state corporation taxes. About three-fourths of the states impose some type

of capital stock tax and approximately one-fourth of them levy corporate excess taxes; but in both cases the amount of the tax is computed differently from the amounts imposed by the federal government. In many instances also the variations among the state taxes are considerable. The 1935 amendments to the federal law will add no procedural difficulties to those already in evidence; but higher rates, enacted apparently without extensive consideration of the state taxes,[1] will impose added loads on corporations doing business in states that have high rates on the basis of capital stock or on the basis of corporate excess. Practically all the states imposing the corporate excess tax levy the general property tax rate on the capitalized value of excess earnings. In consequence, it is fair to say that the state rates are already substantial. It is equally fair to contend, however, that corporations enjoying such generous rates of income can presumably pay a high rate of tax without damage to themselves or their stockholders.

As has already been pointed out by Professor Lutz, the changes in the personal income tax law effected by the 1935 legislation concerned the rates almost exclusively. The net effect of the legislation was to increase the surtax imposed under the Revenue Act of 1934 to 75 per cent on incomes in excess of five million dollars. This legislation when read in conjunction with state income tax rates now attaining a maximum of 15 per cent or more in certain states clearly subjects large incomes to aggregate rates which it will be profitable to evade. It is reasonable to suppose that individuals receiving very large incomes will develop methods whereby these extreme rates may be legally avoided or illegally dodged.

Difficulties brought about by the 1935 Federal Revenue Act were enhanced, also, by state legislation during 1935 which provided for extremely high rates in a number of states. As a matter of fact, in several other states having income taxes the rate levels were substantially increased, either as temporary or as permanent readjustments. The state rate increases, however, in all except about three states were, viewed without regard to the federal taxes, entirely reasonable. State legislation has also had the effect of extending the number of individual income tax states by five. Among the newcomers in income taxation are such rich commonwealths as California and Pennsylvania.

In submitting his tax message to Congress, as other speakers have indicated, President Roosevelt proposed an inheritance tax on large distributive shares of estates. Adoption of such a plan would have involved serious direct conflicts with state tax practices. In addition, it would have introduced certain serious administrative problems for the Treasury. In the light of these circumstances, after long deliberation Congress decided to amend the estate tax provisions of the Revenue Act of 1934 by increasing the rates, instead of adopting the tax on distributive shares. The net effect of the changes in the estate tax rates on federal-state relationships is not as serious as heavy taxes on distributive shares would have been. The principal difficulty introduced is simply that of rendering more grotesque the already unfortunate division of death tax revenues by the federal

[1] None of the official witnesses emphasized this aspect of the problem before either of the congressional committees. When a private citizen, appearing before the House Committee on Ways and Means, introduced the problem, he was interrupted (*Hearings*, p. 369) by an inquiry as to whether there was anything else he desired to tell the committee.

government and the states. The large estate is obviously more interstate in character than the small; and yet the proportion provided under the new rates ranges from nothing at all on estates of from forty thousand to a hundred thousand dollars to nearly 28 per cent of the total on estates in excess of fifty million dollars. Obviously, if the legislation were more realistic it would have provided for graduation of the credit, if any, to give the states a larger proportion on small than on large estates. The legislation of 1932, 1934, and 1935 has progressively rendered the inequity greater and greater.

It may be agreed that there is one definite justification for maintaining the existing plan of crediting state death taxes against the federal estate tax. If the plan were changed there would be an upset in the adjustment of the various states to the new federal situation, and added confusion would be an immediate result. It would be possible, however, by amending the normal tax subject to the credit imposed by the Revenue Act of 1926 to provide approximately a flat rate subject to credit and surtaxes similar in effect to those now imposed, with which Congress could experiment. Incidentally, I deplore rate changes in death taxes as much as anybody, but I should think it a grave misfortune if the credit, graduated as now, became a part of the permanent national tax plan.

Congress, although increasing gift tax rates materially, still did not provide any credit for state gift taxes. Clearly the offset provision is as essential for gift as for death taxes.

The great bulk of the consumption taxes which would have expired during 1935 was re-enacted and certain additional measures were introduced. However, there are no new sorts of conflicts between federal and state taxes as a result of 1935 legislation. The most important federal change, aside from re-enactment of the so-called manufacturers excises and certain other similar measures, was the legislation affecting the Agricultural Adjustment Administration imposts. These were frozen into statutory form at the existing rates with provisions for administrative changes under specified circumstances, and certain new taxes were levied for the first time. Of the latter, the most interesting from the viewpoint of federal-state tax relationships is the tax of .75 cents a pound on potatoes. This, of course, is superimposed almost directly on state sales taxes designed to fall on consumers. However, there is no procedural difficulty as between the federal treasury and the states in the case of this or any other 1935 consumption tax.

State legislation tends to enhance some of the consumption tax difficulties, in that several new states introduced general sales taxes, tobacco excises, alcoholic beverage taxes, and other duplicating levies. Aside from the liquor taxes, the problems involved have to do mainly with rates and rate relationships and do not introduce other serious problems. The objection to these duplicating levies is the uneconomical dual administration and the high rates, and not the extraordinary expense and inconvenience occasioned taxpayers. It must be remembered, however, that payment of two taxes is invariably more expensive for taxpayers, other things equal, than payment of one.

ROYAL S. VAN DE WOESTYNE: The discussion of a paper such as that by Professor Lutz is difficult. Its cogency and conclusiveness make comment almost superfluous and disagreement virtually impossible. For certainly no one who makes any pretense of being a scientific student of public finance can differ

fundamentally with the economic and fiscal analysis by Professor Lutz or with his conclusions. It must be conceded that the Revenue Act of 1935 falls far short indeed of being a notable improvement in our federal tax system if appraised in terms of the economic and fiscal principles which, as the writer properly informs us, are the deposit of a long period of economic thinking.

I propose, however, to offer a few observations not wholly in accord with those of Professor Lutz and to rest them upon somewhat different bases from those employed by him.

Despite its shortcomings, the Revenue Act of 1935 may have its compensations. I shall discuss certain aspects of it which may to some extent offset its failures, without, however, attempting to defend the Act on the grounds taken by the author of the paper.

Professor Lutz refers to the Revenue Act of 1935 as having been "forced through a reluctant Congress," and alludes to "the events and circumstances that emerged between January and June and that were responsible for the change of attitude" on the part of the President which led him to submit a tax message to the Congress even though he saw no need for additional legislation six months previously. More should be made, it seems to me, of those "events and circumstances" in appraising the tax measure than Professor Lutz has made of them. In fact, in the light of those circumstances, may it not be somewhat nearer the truth to say that not only was enactment of new tax legislation forced upon a reluctant Congress but that it was likewise forced upon a reluctant President—that forces over which he had little or no control compelled him to take a step which seemed expedient yet unwelcome? If that be true, as I am convinced it is, judgment concerning the Act must be altered accordingly. Thus, if one looks upon the tax legislation of 1935 as being partly, if not largely, a shrewd political stroke for heading off a far more objectionable, if not positively dangerous, share-the-wealth movement which was assuming ominous proportions in the early part of the year, one cannot help feeling somewhat more kindly toward it than if one judges it solely as an economic and fiscal measure. Indeed, so looked upon, its very failure to effect significant changes and its deferred application almost become virtues rather than defects. To accept the lesser of two evils or to pursue the less dangerous of two courses may at times be just good statesmanship. Politically speaking, seeming to concede and yet withholding is sometimes imperative and simply evidence of consummate administrative skill.

Now I use the word "political" in this discussion not narrowly, as descriptive of vote-getting tactics, but in the more laudable sense as referring to government's vital and difficult job in a democracy of composing diverse group interests and pressures. And my point is that perhaps the Revenue Act of 1935 deserves to be looked upon primarily, albeit unfortunately, as a political and not as an economic or fiscal measure, and that we probably do it an injustice if we fail so to look upon it.

I pass now to a consideration of the avowed primary intent of the Act, namely, to redistribute wealth, upon which Professor Lutz expressed a decided opinion. I am wondering whether there is not some warrant, under certain conditions, for questioning the contention that the use of the taxing power is inappropriate as a means for bringing about a different distribution of wealth from that which pre-

vails. Now I realize full well that certain principles of taxation have been painfully formulated over a long period of time and that they are jealously guarded by economists and others; but I am not convinced that "the whole duty of man and the State amid our modern perplexities," to borrow a phrase from Stamp, is necessarily to be found at all times in those principles, which, among other things, assure us that the primary purpose of a tax should always be to raise revenue. In the practical task of grappling with the many difficult issues that confront us in these days, they may at times be lacking. On this point I appeal to the statement of Marshall in his *After-War Problems* that "the State should use its powers for promoting such economic and social adjustments as will make for the well-being of the people at large." If one takes that position, one is probably compelled to recognize the right of the state to improve well-being by way of taxation; and if it is felt that there are differences in wealth that cannot be justified on either ethical or economic grounds, there is some warrant, it appears to me, for the exercise by government of its taxing power to effect a redistribution, always provided, of course, that the economic consequences of such action are not harmful to social progress. Incidentally, it should be noted that, strictly speaking, the charge that such redistribution is socialistic can be made only if that which is taken away from those who are wealthier is handed over directly to those who are poorer, and is not needed for or applied to the financial needs of the state.

Now I realize that there is a wealth of weight in the argument used by Professor Lutz that measures designed to prevent great inequalities in the distribution of wealth are less dangerous and more effective in the long run than to try to reduce the inequalities after they have appeared. But I also realize that at times we may be confronted with a situation that has come about as the result of the operation of certain forces over a long time, and that conditions may call for early correction. It is then too late to resort to preventive measures. If we wish to reduce great inequalities in the distribution of wealth which have come about because we failed to take preventive measures in time, we may have to resort to the less desirable method of taxation. Furthermore, it does not seem to me that as a nation we are likely to take serious steps to prevent great inequality of wealth. In that connection I should like to quote a statement from Professor Lutz's paper. He tells us that "deliberate taxation to redistribute wealth necessarily involves relative disregard of established principles of fairness and equity. It is necessarily and intentionally discriminatory." I am tempted to paraphrase that and put it in the past tense and to say that "deliberate accumulation of wealth —at least in far too many instances—has necessarily involved relative disregard of ordinary principles of fairness and equity. It has been necessarily and intentionally discriminatory." I confess that I am not at all heartened by the reading of certain chapters in American economic history.

In concluding this part of my discussion may I say that I am in no sense filing a brief for the redistribution of wealth. That is another matter and calls for totally different treatment. All that I have tried to discuss is the possible rôle of taxation in the redistribution of wealth, if redistribution is sought. I hope that I shall not be misunderstood, or looked upon as a mere apologist for the present political administration.

Professor Heer, in his paper on the "Relations between Federal, State, and

Local Finances," has supplied us with an excellent and thorough analysis of our intergovernmental fiscal relations, of the problems arising out of those relations, and of the various solutions proposed for dealing with those problems. I find his paper extremely illuminating and suggestive. And his own recommendation, viz., that there be created a commission on intergovernmental fiscal relations, with planning and advisory functions, seems to me to be thoroughly sound and valuable and worthy of the most serious consideration. I am particularly impressed by Professor Heer's statement that "there are issues at stake which cannot be settled on the basis of scientific principles," and that the whole question "involves issues which are outside the sphere of the expert." This point of view he incorporates, and wisely, I feel, in his suggestion that the planning and advisory agency be composed of both technical experts and "those who are skilled in interpreting what the public wants, or at least what its legislative representatives will ratify." That is another way of saying, if I understand Professor Heer correctly, that he would take into account the political as well as the strictly scientific aspects of the problem, a point of view that I have already emphasized in this discussion. In short, in the broad field of public finance there is probably room as well as need for both the artist and the scientist.

THE ADJUSTMENT TO INSTABILITY

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I

What possibility is there that production and employment can be kept steadily growing in a world where virtually everything else is highly unstable—a world in which inventions and discoveries occur at an uneven rate, in which there are years of good crops and bad, in which consumer preferences change suddenly and often substantially, in which there are wars and rumors of wars, in which political conditions change overnight and often with some violence. Rarely, if ever, do events which are favorable and those which are unfavorable for business precisely balance one another; usually there is a preponderance of favorable or unfavorable developments. In short, we live in a world dominated by accidents. There are two ways of attacking the problem of economic instability. One may be called the method of insulation—building an economy which is effectively insulated from the world in general so that production and employment go on undisturbed by the irregular flow of events. The other may be called the method of adjustment—creating an economy which is capable of adjusting itself instantly to changes in technique, consumer preferences, and the outside world.

An insulated economy would be a socialistic economy, because it would necessarily be one in which production was carried on independent of changes in the prospects for profits. That is not the alternative which I propose to discuss. I address myself to the possibility of achieving stability, not through the method of insulation, but through the method of adjustment, and I ask the questions: "Can capitalism be made to operate so that its internal adjustments to the highly irregular flow of events will never take the form of violent fluctuations in production and employment? What conditions must be satisfied and what prospect is there of satisfying them?"

II

Spending falls into three principal classes: spending by business enterprises, spending by individuals, and spending by the government. For the time being I shall neglect spending by the government. The incomes of individuals are in the main simply the expenditures of business concerns. Individuals spend part of their incomes for consumers' goods. The remainder they either hold in cash or turn over to business enterprises to invest in plant, equipment, or inventories.[1] The willingness of business concerns to invest their own profits and the savings of the rest of the community

[1] Since for the time being I am disregarding government spending, I disregard also the part of consumers' incomes which are transferred to the government in taxes, fees, or the purchase of government securities.

depends upon the outlook for profits. So also does the willingness of enterprises to make many expenditures of a more or less current nature. For example, when the prospect for profits becomes less favorable, many concerns reduce their current outlay by letting inventories drop, by postponing replacements, and by permitting standards of maintenance to fall and postponing many repairs and replacements. The postponement of repairs and replacements may even reduce the current disbursements of business concerns below the cost of producing current output. In this event, business as a whole will be conducted at a loss.

Let us suppose that the outlook for profits becomes less favorable with the result that enterprises reduce their current expenditures and also their willingness to invest their own profits and the savings of the community in inventories, plant, and equipment. If individuals, finding their incomes shrinking as a result of the drop in business spending and finding no market for their former volume of savings at the former rate of interest, were to save less and to purchase more consumers' goods, the drop in the volume of business spending would not go far, because the increase in the demand for consumers' goods would improve the prospects for profits in the consumer goods industries and halt the drop in business spending. This, however, is precisely what does not happen. In the face of falling incomes individuals do not cut their savings sufficiently even to maintain their purchases of consumers' goods. On the contrary, they reduce their demand for consumers' goods. Hence, a drop in business spending is followed by a drop in the demand for consumers' goods, and by an increase in the idle cash balances or a decrease in the debts of individuals. This reduces the opportunity for profit still further and thus produces a further drop in the volume of business spending.

III

I have said that the volume of business spending depends upon the outlook for profits.[2] This expression is conveniently brief, but it is somewhat misleading. I am using it to cover two more or less independent things—the outlook for profits as business managers and business owners see it and their disposition to take chances. The business man is a dealer in uncertainties. He can never be sure whether his ventures will turn out to be profitable or unprofitable. As risks change, his willingness to assume them changes, the possible profits that he expects increase or diminish. Furthermore, the prospect for profits is a subjective matter. Whether it looks favorable or unfavorable depends upon whether the business man happens to be in an optimistic or pessimistic mood. For this reason the business man's demand prices for factors of production fluctuates more than does the

[2] By profits I mean the entire return of business owners—for capital, labor, and risk bearing.

marginal worth of the factors. By prospects for profits is meant, of course, not the outlook for profits for each enterprise as a whole, but rather the outlook for profit from particular expenditures. An enterprise may be deeply in the red and yet the management may be discovering many ways in which money can be advantageously spent. Conversely, current profits may be large and yet the management may find a few new ways in which expenditures can profitably be made.

IV

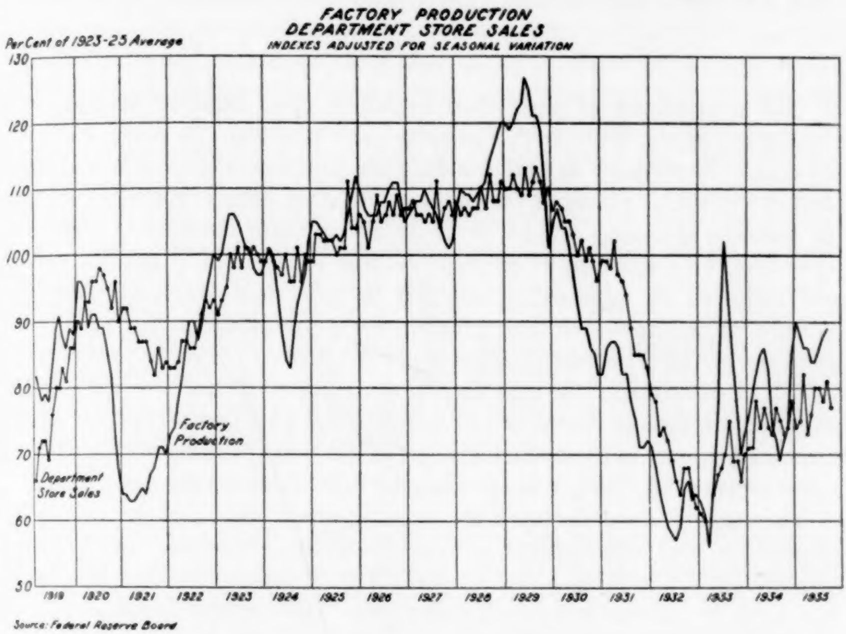
What determines the prospects for profit? Are they not fundamentally determined by the willingness of individuals to spend their income for consumers' or capital goods? Thus while business spending may determine individual spending, is it not equally true that individual spending determines business spending? The outlook for profits is, of course, partly determined by the willingness of individuals to spend, but it also depends upon price relationships and upon the success of managements in discovering advantageous changes in products, processes, equipment, arrangements of plants, and methods of marketing. When the cost of change is high relative to selling prices, managements are less successful in discovering changes which would be advantageous. It is because the outlook for profits is in large measure determined by price relationships and by the success of business men in making discoveries that the volume of business spending determines the volume of individual spending and that the total volume of spending in the community is fundamentally determined by the prospects for profits and fluctuates with changes in these prospects.

As a matter fact, it would be surprising if the decisions of business men did not fundamentally determine the volume of spending in the community. Business men are professional spenders. Consequently, they may be expected to adjust their spending to changed conditions more promptly than the rest of the community. Statistical confirmation of the expected relationship between business spending and individual spending is provided by the movements of factory production and department store sales. Month-to-month figures are available for the last fifteen years. Their movements are shown in the chart on the opposite page. These figures reveal that department store sales lag behind factory production by one to six months. The high and the low points of the principal business swings were as follows:

	Factory Production	*Department Store Sales*
High	January-February, 1920	July, 1920
Low	March-April, 1921	September, 1921
High	April-May, 1923	August-October, 1923
Low	July, 1924	July-August, 1924
High	September-October, 1926	October, 1926
Low	November, 1927	September, 1927

High	June, 1929	June and September, 1929
Low	July, 1932[8]	August, 1932[8]
High	July, 1933	August, 1933
Low	September, 1934	July and October, 1934
High	January, 1935	March, 1935

The comparison is admittedly crude because the outlays of business concerns in connection with factory production represent less than half of all business spending and because department store sales represent only a small part of expenditures by individuals for consumption goods and may not always be representative. Nevertheless, the consistency of the lag of depart-



ment store sales behind factory production is striking. It is particularly clear in the case of the major turning points, such as 1920, 1921, 1923, and 1929. In 1927, the low point in department store sales preceded the low point in factory production by two months. The recession was so slight, however, particularly in department store sales, that the small month-to-month changes appear to possess little significance.

Note that the distinction which I make between business spending and individual spending is somewhat different from the one frequently made between the activity of consumers' goods industries and of the so-called

[8] In March, 1933, both factory production and department store sales fell slightly below their lows of the summer of 1932. This, of course, was due to the closing of the banks. The significant turning point of the depression seems to have been the summer of 1932.

capital goods industries.[4] The available data from different countries and different periods do not clearly indicate whether the production of capital goods leads or follows the production of consumers' goods. Rather the divergence in the results leads one to suspect that there may be no regular order of precedence. Naturally, it is difficult to reconcile these results with the underconsumption of Hobson and Foster theories of the business cycle, on the one hand and with the monetary overinvestment theories of Hayek and his followers on the other. As between business spending and individual spending, however, there is reason to expect business spending to move first, and that is what the data seem to show.

V

The dependence of individual spending upon business spending has important implications, both theoretical and practical. To begin with, it is of crucial importance in undertanding the problem of economic instability and in formulating policies for dealing with it. In a stable economy, changes in business spending would be offset by opposite changes in individual spending. Our economy is unstable because changes in business spending are followed by aggravating changes in individual spending. Since the volume of business spending depends upon the prospects for profits, the achievement of economic stability requires either (1) that the prospects for profits be prevented from ever becoming darker no matter how unfavorable may be the course of events or (2) that artificial arrangements be introduced into our economy to assure that changes in business spending will be offset in some measure by changes in spending by individuals or the government.

This analysis sheds light on the popular superstition that the volume of production and employment is fundamentally determined by consumer purchasing power. Even a few economists make this assumption. For example, John A. Hobson in a recent paper says, "Underconsumption is the root cause of underproduction."[5] This view of the matter has cause and effect reversed. It overlooks the fact that changes in consumer incomes, and therefore in consumer purchasing power, simply reflect changes which have already occurred in business spending. Consumer incomes are fundamentally determined by the volume of production, and underconsumption is a necessary result of underproduction.

This analysis goes far in explaining why the markets for goods are always in a precarious position and why production and employment are always in danger of dropping. At all times the volume of business spending and hence the volume of consumer incomes are what they are because new ways of

[4] By capital goods is usually meant equipment goods and construction materials rather than all the intermediate goods which the economist has been in the habit of defining as capital goods.

[5] *The Burden of Plenty*, p. 55.

making money are being discovered at a certain rate. Consequently, we are in the grip of a process of discovery. Let the rate of discovery drop and the volume of spending will promptly drop. Whether we are rich or poor, whether we have poverty in the midst of potential plenty depends upon the success of business men in discovering new ways of spending money to advantage. The economy may be in equilibrium, but only because new discoveries are being made at a certain rate. Any drop in the rate of discovery will bring a drop in business spending and an accentuating drop in individual spending. In the language of technical economics, the marginal worth of the factors of production is always in danger of dropping. It is what it is because new uses for productive factors are being discovered at a certain rate. The marginal worth of labor, for example, depends, among other things, upon the success of business men in discovering new ways of making money. Whether it is advantageous for industry to buy enough goods at high enough prices to keep labor worth its existing wages and, therefore, to maintain employment depends upon the success of business men in finding new ways to make profit. Let them have less success in discovering new ways of making money and the volume of spending and the marginal worth of labor will both drop. All of this means that a spiral of contraction may start from a condition of equilibrium, unless the fall in the rate of discovery is instantly offset by a drop in the cost of change, or an increase in the expenditures for consumers' goods, or both. From this follows the important practical conclusion that prevention of the excesses of booms, though important, will not prevent depressions.

VI

Our analysis has indicated that there are two directions in which the solution of the problem of economic stability may be sought. One is along the line of stabilizing the prospects for profit; the other along the line of divorcing individual incomes in some measure from business expenditures. Let us first examine the problem of stabilizing the prospects for profit. Time compels me to omit a detailed analysis of the problem of controlling booms and to focus attention almost entirely upon the problem of depression. First of all, however, let me direct your attention to certain accounting changes which would limit the extremes of both booms and depressions.

Since business men are in the habit of judging prospective profits by present profits, changes in accounting which would reduce the fluctuations in profits would help to stabilize the emotions and, therefore, the expenditures of business managers. Business men quite commonly fail to distinguish between inventory profits and losses and operating profits and losses. Strictly speaking, inventory gains should not be regarded as profits, because a rise in the prices of materials will some time be offset by a fall. Since the inventory gains of today are simply the basis for inventory losses tomorrow, in-

ventory gains, instead of being counted as profits, should go into a reserve against inventory losses. A rise in raw material prices would then automatically create a charge against current income for the inventory reserve; a fall would release funds from the reserve. By this simple device it becomes possible to pay dividends out of inventory losses!

Depreciation and obsolescence must be paid for out of production. Consequently, charges for depreciation and obsolescence should rise as output rises and fall as output falls. The current practice of charging depreciation at so much per year causes each unit of output to bear less than its share of depreciation during periods of extra large production and more than its share during slack periods. Please observe that I am not asserting that the rate of production determines the rate of depreciation and obsolescence. I am simply asserting that the cost of replacing equipment can only be recovered out of production and that it should, therefore, be a tax on output, fluctuating as output fluctuates. These two devices—the separation of inventory gains and losses from operating profits and the adjustment of depreciation and obsolescence charges to the rate of production—would substantially diminish the fluctuations in profits in many industries.

VII

Suppose that contraction sets in. Experience shows that commodity prices fall sooner and farther than the cost of producing commodities. What can be done to improve the prospects for profits? A suggestion frequently made is that the price level be raised. Unfortunately there appears to be no satisfactory way of operating directly on the price level. Time was when many economists believed that the price level could be controlled by manipulating interest rates. Today it seems clear that the price level is determined by price relationships and fluctuates with changes in them, because price relationships determine the volume of spending that is profitable. Interest rates are only one among a multitude of prices and are a minor element in the costs of most businesses. Hence changes in interest rates have little effect upon the volume of spending that is profitable.

Some economists advocate controlling the price level through manipulating foreign exchange rates. This device offers the possibility of affecting the price level by movements in export and import prices and in the physical volume of exports and imports—far more powerful levers than interest rates. Whether or not this particular device can be advantageously employed depends upon the circumstances of the particular country—upon the elasticity and inelasticity of the supply of and the demand for its exports and its imports, upon whether the particular prices which would be raised or lowered by a movement in the exchanges are prices which are already too high or too low, upon whether manipulation of the exchanges is likely to provoke retaliation, upon whether it is politically possible to lower the

exchanges as well as to raise them. Certainly the depreciation of its currency by an important creditor country such as the United States with a large foreign trade is likely to provoke retaliation. Furthermore, the importance of several agricultural products in our exports makes it unlikely that Congress would permit exchange rates to be manipulated to limit increases in the price level. If the device cannot be made to work both ways, it should not be used at all. Hence the problem of reducing maladjustments between costs and selling prices seems to take this form: The price level cannot be raised without an increase in spending, but maladjustments between costs and prices prevent an increase in spending; consequently, the elimination of maladjustments between costs and selling prices must begin with reductions in costs.

VIII

To some extent costs may be reduced by improving processes and by making productive factors more efficient. A substantial drop in net incomes gives managements a tremendous incentive to search for ways of cutting costs, and an increase of several million in the unemployed helps managements substantially to raise the efficiency of labor and thus to diminish the maladjustments in the price structure. I attach great importance to managerial methods of reducing maladjustments in price relationships.[6] In a mild depression, managerial improvements may be sufficient to start revival. It is worth noting that the country recovered from the depressions of 1924 and 1927 without general wage reductions. If managerial methods do not suffice to increase the volume of spending that is profitable, then it is apparently necessary to reduce the prices which govern costs. As over three-fourths of production costs in a consolidated income statement for American industries consists of wages, it is extremely difficult to make substantial reductions in the costs of industry as a whole without reducing the price of labor.[7] Many economists and non-economists believe, however, that wage reductions will do harm rather than good. The opponents of wage cuts do not, as a rule, object to reductions in other cost-determining prices—in fact, they favor them. They believe, however, that reductions in wages will diminish the total volume of labor income, and that, during periods of contraction, wage earners spend their income more promptly than business concerns and business owners. Hence, it is argued that a diversion of income from wage earners to business enterprises will reduce the demand for goods, particularly consumers' goods, precisely when business urgently needs larger markets.

[6] Unfortunately the drop in the flow of work may largely offset the efforts of managements to cut operating costs.

[7] Because of the limitations of time, I concentrate attention upon the problem of reducing wages. This is not intended to imply that I am opposed to reductions in other forms of costs. As indicated above, I do not believe that in severe depressions the reduction of non-labor costs is likely to be enough, for the simple reason that they represent such a small proportion of total costs.

It is plain that the argument against wage reductions is fallacious in case the demand for labor happens to be elastic. In that event the very reasoning which is employed to prove that wage reductions will accentuate the depression can be used to show that they will alleviate it. During periods of contraction most plants are undermanned. This fact suggests that the demand for labor at such times is elastic. Since plants are undermanned, additions to the force (up to the number for which the equipment is designed) may be expected to result in an almost proportionate gain in output. Hence, a small drop in the wage rate would make profitable a large increase in employment.

Other considerations, however, lead me to believe that the demand for most types of labor during periods of contraction is inelastic. In favor of this view it may be argued: that employers will not increase production during such periods in advance of an increase in orders; that in a large part of industry monopolistic competition will prevent a significant cut in selling prices in response to a reduction in prime costs; that price cuts will do little to stimulate the sale of most types of goods, because the general apprehension that grips the community during periods of contraction puts all buying on a more or less hand-to-mouth basis and thus makes for great inelasticity in the demand for practically all goods; that increases in sales and production will result in only small additions to working forces because employers will hire only the workers essential to get out the additional output and will defer hiring auxiliary types of labor that are not immediately needed, such as repair and maintenance men, until floating debts have been substantially reduced and the financial position of enterprises is more comfortable.[8] Certainly in considering the practical wisdom of wage cuts, it is only conservative to assume that the demand for labor is inelastic and to analyze the consequences of wage cuts on this assumption.

Let us start, therefore, with the assumption that the initial effect of wage cuts during periods of contraction is to reduce labor income. During such periods, business concerns and their owners are probably less disposed than wage earners to spend their incomes promptly.[9] Hence, a diversion of dollars from wage earners to business enterprises and business owners may also have the initial effect of reducing the velocity of circulation, and hence the total

[8] Perhaps it is worth while again to remind the reader that business men really never know what is the marginal worth of factors of production. They are constantly dealing with uncertainties and it is always more or less a matter of guesswork whether it will pay them to use more labor at existing prices and, if so, how much more. One good reason for regarding the demand for labor as inelastic during periods of contraction is that business men are not in a chance-taking mood. The fact of contraction shows that. Consequently, a reduction in wages is not likely to have a very immediate effect upon the volume of employment. Business men are likely to pursue a "wait and see" policy before taking on more men.

[9] Data are not available on this point. I suspect that the difference between spending disposition of wage earners and business enterprises is less than is often supposed by the opponents of wage cuts. Nevertheless, it is simply conservative to assume that during such periods wage earners spend more promptly than business concerns.

volume of spending and the markets for business. This might lead one to suppose that wage cuts should be avoided at all costs. Nevertheless, unless business concerns and owners hold all of the additional dollars which were diverted to them and do not increase their expenditures at all, the initial effect of wage cuts would be to reduce the expenses of business by more than the demand for goods. Let us assume, for example, that wage cuts reduce the disbursements to men already on the pay-roll by $500,000,000. Suppose also that business enterprises employ $200,000,000 out of this saving to increase their cash balances and spend the remainder on repairs, replacements, improvements, and inventories.[10] The demand for goods in consequence will be reduced by $200,000,000, but business concerns find their profits increased or their losses reduced by $300,000,000. The reduction in wages seems to have been worth while; it has materially improved the profit position of business.

I should be the first, however, to insist that the wisdom of wage cuts must not be judged simply by their initial effects. Let us, therefore, inquire into some of their secondary consequences. An important characteristic of a period of contraction is that business concerns endeavor to increase their cash balances or to reduce their bank loans by not spending all of their current income and by avoiding many postponable expenditures, such as outlay for repairs, replacements, improvements in processes, and product. Industry will emerge from depression only as and if enterprises become willing to make expenditures which might be postponed.[11]

Wage cuts tend to break down the unwillingness of managers to make postponable expenditure. One initial effect of wage reductions, as I have pointed out, is to increase the profits or decrease the losses of enterprises on orders in process or on hand. This means that, temporarily at any rate, business concerns are helped to build up their cash balances and to reduce their debts. The very increase in cash balances and reduction in debts tend to diminish the utility of additional dollars used for these purposes and the drop in the cost of repairs, replacements, and various improvements raises the return on dollars spent for these purposes. Thus wage cuts tend to increase the volume of expenditures which enterprises are willing to make against given holdings of cash.

But matters may not work in accordance with this analysis. One difficulty is that wage cuts may cause business men to postpone commitments in expectation of lower prices. One cannot be certain that this will happen, because wage cuts tend to raise the prices of many raw materials, such as

[10] Or it may be assumed that all or part of $200,000,000 is used to repay bank loans and that the banks are unable or unwilling to offset the repayment of old loans by an expansion of new loans.

[11] In fact, full recovery cannot be attained until enterprises become willing not only to spend (or to disburse in dividends) their whole income, but to absorb the savings of the community in expanding plants and equipment.

farm products, and of intermediate goods. The reason is that the demand schedule for raw materials is determined at any given moment in large measure by prevailing selling prices minus prime labor costs. Hence a reduction in prime labor costs tends to raise the demand schedule for raw materials and intermediate goods. Nevertheless wage cuts are likely to reduce the supply prices of most commodities and hence to produce some postponement of commitments. If the postponement of buying is sufficient, selling prices will drop so much that the original maladjustment between costs and selling prices is accentuated rather than diminished.[12]

A second difficulty may arise because the diversion of dollars from wage earners to business owners, resulting in a drop in the total volume of spending, produces a drop in the demand for consumers' goods. In fact, the initial drop in the demand for consumers' goods is likely to approximate the initial drop in the volume of total spending. This means that the full impact of the initial drop in spending produced by wage cuts will be felt by retail stores and soon afterward by factories which finish consumers' goods. These concerns are not likely to save enough from lower wage rates to offset the drop in the demand for their products. Their profits, therefore, will decrease or their losses increase. And their demand for intermediate goods will drop. Indeed a moderate drop in retail sales will produce a pronounced drop in the demand by stores for finished goods which, in turn, will produce an even greater fall in the demand by manufacturers for raw materials. Thus the initial drop in retail sales will tend to make itself felt with cumulative effect throughout industry. As it does, it will tend to destroy the disposition of business concerns to increase expenditures which was started by the greater profits which they received as an initial effect of wage reductions.

The crucial question, obviously, is whether enterprises will increase their expenditures promptly enough to offset the initial drop in the demand for consumer goods. If business concerns promptly made postponable expenditures in response to the greater profits on current output and the lower cost of change, the initial drop in consumer demand would be brief and would be followed by a quick pick-up. This would cause retailers to place rush orders that would offset the initial drop in their orders. Since the drop in consumer demand will occur very promptly and since business managers during periods of contraction are in a cautious and a "wait-and-see" frame of mind, it seems virtually certain that business spending will not increase soon enough to halt the contraction started by the drop in consumer demand. Thus a dilemma seems to confront us. Some movement of wages and other cost-determining prices is necessary in order to improve the relationship

[12] That is, the postponement of buying by business enterprises may reduce their volume of spending by more than the total number of dollars diverted to them by the reduction in wages.

between costs and selling prices and to help business men find advantageous ways of spending money. However, because of the peculiar conditions which exist in a period of contraction and because of the structure of modern industry, wage reductions seem to lose the power of performing the function that economic theory assigns to price movements; namely, the removal of maladjustments from the price structure.[13]

It would be erroneous to deduce from this analysis that wage cuts should not be made. The fundamental case in favor of them is not altered. It remains true that lower costs relative to selling prices are needed in order to induce enterprises to make postponable expenditures. The above analysis indicates, not that the price of labor should be maintained, but that drops in labor income should be avoided. Consequently, the technical problem that confronts us is how to reduce the price of labor in a period of contraction without reducing labor income. Four procedures occur to me. In the first place, it is desirable that wage reductions be made promptly in periods of recession before the demand for goods has had an opportunity to become inelastic. In the second place, collective bargaining might be used to reduce the inelasticity in the demand for labor during periods of recession. Neither the theory nor the practice of collective bargaining has been developed to take much account of the business cycle. Hence, trade unions have been primarily interested, not in selling labor or in preserving labor income, but rather in pegging the price of labor. If they were to bargain for labor income as well as for wage rates and try to sell labor as well as to protect the price for labor, they could trade definite concessions in wages for definite undertakings on the part of employers to increase their payments to labor or not to diminish their payments. During the negotiations for a reduction in railroad wages several years ago, the railway unions attempted unsuccessfully to bargain for partial maintenance of income. In several localities during the depression the electrical workers union seems to have followed the policy of attempting to sell labor rather than simply to maintain a price. In the third place, employers who reduce wages on their own initiative should, in the interest of general stability, definitely plan to spend a large part of the savings from wage cuts on repairs, replacements, and improvements rather than merely on the reduction of bank loans. Finally and most important of all, the above analysis indicates the importance of divorcing the incomes of individuals, in some measure, from the expenditures of business concerns. Let us, therefore, consider ways and means of doing this.

[13] How then does revival from depression ever occur? The contraction of spending may be ended by the physical necessity of making repairs and replacements and of replenishing inventories, by the overdoing of pessimism, and by a fortuitous combination of favorable events. It is desirable to recognize the major importance of accidents in determining movements of business. This is an inevitable result of the fact that prices do not move fast enough to prevent maladjustments in the price structure.

IX

There are two reasons why it is necessary to divorce individual incomes in some measure from business spending. First, it is needed in order to limit the contraction produced by the initial drop in business spending which marks the inception of depression. Second, it is needed, as indicated above, in order to enable business enterprises to cut their costs without producing an even greater drop in selling prices.

Individual incomes which are not derived from business spending must come either from the government or from reserve funds. In order to produce the desired effect, the disbursements from the public treasury or from reserve funds must not correspondingly diminish the expenditures of business concerns or individuals. This means that these disbursements must be financed, not by taxes, but out of savings that would otherwise be hoarded, out of accumulated bank balances, or by the extension of bank credit.

Unemployment compensation seems to be the best device for replacing promptly part of the income which wage earners lose whenever business spending drops and thus for limiting the resulting contraction. The very reduction in business spending, by producing unemployment, makes men eligible for benefits. Public works could not be expanded on a large scale so promptly. Of course, unemployment benefit payments cannot entirely offset the drop in business spending, partly because a fairly extended waiting period is needed in order to make possible the accumulation of funds for use during depression, and partly because benefit payments must for various reasons be kept substantially below wage rates.

Unemployment benefits, however, are not a suitable device for offsetting the drop in labor income which is the initial effect of reductions in wage rates, because the volume of unemployment benefits is determined by the volume of unemployment. The drop in consumer demand which may be expected to follow wage cuts must be offset, therefore, by other means. Two principal devices occur to me. One may be called "labor income reserves"; the other is public works. By labor income reserves I mean reserves built up for the purpose of maintaining labor income when the price of labor is reduced. The present unemployment reserve plans could be converted into labor income reserves by the simple device of broadening benefit payments to cover income lost as a result of wage cuts as well as income lost as a result of unemployment. Eventually such a change may be made in the present unemployment reserve plans, but there are many difficulties to be overcome, particularly in the case of the pooled reserves. In any event, the ground for the change must be prepared by the establishment of labor income reserves through the method of private negotiation, because experience shows that labor legislation is simply a method by which the private practices of industry are converted into public policy. I pointed out above that neither the theory nor the practice of collective bargaining has been

developed to take account of the business cycle. As business men and labor leaders come to understand more clearly the need for steadiness in labor incomes and for fluctuations in the price of labor, trade agreements may provide for the establishment of labor income reserves.

Since many years will be required before labor income reserves become sufficiently numerous and large substantially to offset the effect of wage cuts upon labor income during periods of contraction, another device is needed. The best that I am able to suggest is the expansion of public works. The use of public works for this purpose is not without grave difficulties and I recommend the device only because no other seems to be available. To begin with, it is not easy for the government to expand suddenly and substantially its expenditures for construction. Still more difficult is it to make such expansion coincide with wage reductions, unless the government is able to control the timing of wage reductions. Finally, an expansion of public works may preserve maladjustments in the price structure by keeping up some prices which need to fall. As pointed out above, business emerges from depression when managers discover a sufficient number of new ways to reduce costs or to make money. Obviously this is likely to require a drop in the cost of capital equipment and the labor used to install it. But it is precisely these prices which are kept up by a large program of public works. The government might, of course, use its great buying power to force concessions in the prices of construction materials and construction labor, and it is of the greatest importance that the government pursue this policy. The opposition to be overcome, however, would be very great. Particularly with reference to wages, the politicians are disposed to adopt the easy course of paying the so-called prevailing wage, which in practice seems to be considerably above the market rate. So long as public works are administered in this way, they lose most, if not all, of their value as a device for eliminating maladjustments from the price structure.

Large expenditures on unemployment compensation, wage-loss compensation, and public works might exceed the available surplus of savings over investment. In that event, they would need to be financed by expanding bank credit. This would produce a rise in demand deposits, such as happened on a spectacular scale during the last several years. Huge government deficits financed by bank credit have raised demand deposits above the 1929 level. The velocity of circulation, however, is less than two-thirds of the 1920-30 average. The great increase in demand deposits is dangerous because of the practical difficulties in the way of reducing them in case a rapid increase in the velocity of circulation makes this desirable.

The difficulties are likely to be greater in the case of public works than in the case of unemployment compensation. Taxes which yielded income in excess of the government's current disbursements would tend to reduce demand deposits, but if the surplus income were used to redeem the govern-

ment debt, difficulties would be created. The redemption of bonds held by individuals would create new private demand deposits and the redemption of bonds held by the banks would create surplus bank reserves at a time when this might stimulate a runaway boom. In order to reduce demand deposits effectively, it would be necessary for the government to redeem only bonds held by the Reserve banks or to hoard its surplus income. The former procedure would reduce the control of the Reserve banks over the money market. I need scarcely remind you that Congress might refuse to make the necessary tax increases at the right time or to permit the government to hoard money. And even if Congress did consent to raise taxes and to hold a surplus, it is unlikely that demand deposits would be reduced fast enough to offset a sudden increase in the velocity of circulation. For this reason, the financing of public works by the creation of a large volume of demand deposits during a period of depression must be regarded as dangerous.

The dangers of financing public works by bank credit would be diminished by the simple device of depositing unemployment reserves in the Federal Reserve banks. In periods of depression, the excess of benefit payments over premium receipts would transfer funds from the Reserve banks to the unemployed who would pay them to the grocer, the baker, and the landlord. By this means the reserves of the member banks would be increased and demand deposits would be created in the possession of business enterprises. Since the banks would gain as much in reserves as in demand deposits, most of the gain in reserves would represent surplus reserves. The banks, therefore, could finance a considerable increase in public works by paying cash instead of by extending credit.

It must be confessed that the creation of large additional demand deposits through the payment of unemployment benefits would also involve an inflationary threat, because a sudden improvement in the business outlook might produce a rapid rise in the velocity of circulation and hence cause prices temporarily to go too high in relation to costs. The danger would be less, however, in the case of deposits created by the payment of unemployment benefits than in the case of deposits created by a budgetary deficit, because as rising employment caused premium receipts to exceed benefit payments, funds would automatically be transferred from the commercial banks to the Reserve banks. This result would not depend upon the willingness of Congress to act. Incidentally, this transfer of funds from the commercial banks to the Reserve banks would help solve the difficult problem of applying the brakes, a problem which has given students of banking great concern. The Reserve banks would not have to put on the brakes because they would go on automatically as employment increased. The task of the Reserve authorities would be the popular one of preventing them from going on too hard.

A problem would arise in case the transfer of funds from the member banks to the Reserve banks substantially diminished the reserves of the member banks. A rapid gain in employment might wipe out the surplus reserves of the member banks at precisely the time that the banks needed to give additional accommodation to industry. In order to avoid this result, the Reserve authorities need to be given discretion either to hold the premium receipts in cash or to invest part of them in acceptances or obligations of the United States. The Reserve authorities would then be able to control with precision the effect of the premium payments upon the money market. Nevertheless, it should be remembered that the reduction of demand deposits by the excess of premium receipts over benefit payments would take time. The danger from a sudden increase in the turnover of a large volume of demand deposits created during the depression would not be eliminated. The only way to remove it would be to limit the creation of demand deposits by making prompt adjustments in costs and thus halting the spiral of contraction.

X

This analysis leads to the conclusion that neither deflation in the form of cuts in production costs nor reflation through unemployment benefits or government spending is the remedy for depression. Rather it indicates that a combination of the two policies is required. The ideal procedure, of course, would be to make adjustments in cost-determining prices at the first sign of recession before business men had developed a strong feeling of caution and when reductions in cost would produce a prompt increase in spending by business concerns. If such prompt price movements occurred, there would be no problem. It is precisely because the adjustment of cost-determining prices does not occur until after the demand of enterprises for goods has become inelastic that price adjustments are not enough. They need to be supplemented by the support of markets. The point which I wish to emphasize in particular and which is the essence of my argument is that neither reductions in cost-determining prices nor support of markets is enough. In fact, each alone is dangerous. Each needs to be supplemented by the other.

It does little good, for example, to support markets and to endeavor to prime the pump by government expenditures unless some adjustments are simultaneously made in the relationship between costs and selling prices which help business men discover advantageous ways of spending money. Otherwise, government expenditures simply cause idle deposits to pile up in the hands of business enterprises and cause the government debt to reach alarming proportions. This is clearly demonstrated by the experience of the last two years. In the face of huge government expenditures the velocity of circulation steadily dropped until last August, because the NRA and other administrative policies have done much to preserve maladjustments in the

structure of nonagricultural prices. Likewise, when wages and other cost-determining prices are reduced, it is also essential to support selling prices by public spending, because in order to make business willing to spend, it is necessary that prices be steady and firm as well as that price relationships be favorable.

XI

It is perhaps unnecessary, before concluding my remarks, to remind you of some of the problems which I have failed to discuss. I have given no attention to the problem of insulating a country from fluctuations of business in other countries and I have not discussed the problem of controlling revival and preventing it from developing maladjustments which make a later collapse inevitable. Although I have stressed the importance of introducing greater flexibility into costs, I have had little to say concerning ways and means of achieving this result. Let me conclude with several observations on the problem of introducing flexibility into the price of labor. The crucial question is: "Should the government undertake to regulate wages and to make them flexible?" From the narrow point of view of economic policy, the answer to this question seems to be, "Yes." Central control by the government seems to be necessary in order to make possible prompt and universal adjustments of wages to price movements and to achieve proper timing between wage adjustments and the expansion (or contraction) of public works. And yet I have no hesitation in urging against it, because central control of wages would produce results which are the opposite of those intended.

Whenever the government undertakes to control the people, the people organize to control the government. One can imagine the terrific popular response which would be produced by an effort on the part of the government to control wages. Employers would organize to prevent wages from being raised; wage earners would organize to prevent them from being reduced. As a result, wages would be more rigid than ever. If wages are to be made more flexible, this must be done by the method of private negotiation, and by the development of labor income reserves and forms of collective agreements which make fluctuations in wage rates less objectionable to workers. At least that is true for the foreseeable future. The best that one dare hope for is that the government may be willing to use its public works program in periods of depression to encourage reductions in the prices of construction materials and labor.

It is perhaps worth while to translate these remarks into more general terms. A grave cultural crisis confronts us because economic developments require that organized industry, organized labor, and the government assume new functions which they are not prepared to perform and which the people are not prepared to have them perform. Since ordinary market processes do

not produce the adjustments needed to stabilize production and employment, the achievement of stability requires that these adjustments be made partly by negotiation between employers and labor organizations and partly by governmental action. This means that the government, which traditionally has been a policeman and a judge, defining and enforcing rights and duties, needs to assume the new function of economic manager. The amount of management which the government will need to exercise will depend upon the ability of private organizations to make adjustments by the method of negotiation.

Unfortunately, the prospect is not bright that either private organizations or the government for years to come will be able to perform satisfactorily the enormously difficult task of managing our economy. There are several reasons for this belief. One is the fact that economic problems are not well understood. A second is the fact that the process of management is likely to be so highly political that it will discourage rather than encourage enterprise. This is disastrous in an economic system such as capitalism in which the volume of production and employment depend upon the willingness of private business owners to take chances. A third is that the domination of the government by pressure groups is likely to produce policies which aggravate rather than alleviate the problems which the government is attempting to solve. Men's particular interests are much closer to them than their common interests. Consequently, when the government undertakes to promote common interests, the people organize to compel it to promote particular interests. This situation is aggravated by our present Constitution which prevents responsible party government and thereby permits pressure groups to deal directly with individual members of Congress. The result is government by pressure groups rather than by parties. Unless the power of pressure groups can be restricted, economic management by the government will be devoted in large measure to promoting or protecting special interests, to protecting established enterprises and organizations against innovation and change, and to keeping prices rigid rather than to making them flexible.

The situation seems to boil down to this: The achievement of stability in production and employment requires that industry be subjected in substantial degree to central guidance and management. Good management seems unlikely and bad management is bound to produce a large volume of chronic unemployment. If unemployment is severe, the dissatisfaction of the unemployed and of the taxpayers who must support them may be expected to produce radical changes in our economic institutions.

DISCUSSION

GEORGE SOULE: Let us begin with Professor Slichter's paper. I must register an exception to the first paragraph. Socialism is not synonymous with economic isolation. Germany and Italy are today following the policy of autarchy, although they are about as far from socialism as any régime that can be imagined. The Soviet Union, which is socialist, has been compelled by historic necessity to become nearly self-contained, but this is a departure from socialist theory, which remains internationalist.

On the problem to which Professor Slichter confines his attention, that is, recovery from a depression within the confines of the capitalist system, I am in substantial agreement with much that he says. Careful and complex as his study is, however, it is still too simple, and omits important factors, consideration of which might alter his conclusions. We may mention, merely by way of illustration and without any attempt to follow through their full implications, a few of these omissions.

In certain industries having a large proportion of fixed charges or other overhead that is normally assimilated to capital costs, it may be more pertinent to reduce these charges, in an effort to increase the margin between costs and selling prices, than to reduce labor costs. This is particularly true in periods of slack production, when that part of the unit cost attributable to overhead becomes very large in proportion to unit labor cost. The point is especially clear in the case of concerns which are completely shut down and thus have no direct labor cost at all.

In this connection it should be remembered that during this depression the government has devoted nearly as much borrowed money to the relief of unemployed capital as it has to the relief of unemployed labor. Professor Slitcher has pointed out the danger that unemployment relief in the form of public works tends to prevent adjustment of inflexible wages in building, but it may with equal force be objected that capital relief such as has been extended through the RFC and other similar agencies tends to prevent adjustment of inflexible capital costs. If the government used such agencies to further rather than to prevent necessary capital deflation and reduction of interest rates in such important fields as railroads or urban real estate, it might be possible to lower fixed costs where these are more important obstacles to recovery than are wages.

Another omission of importance is consideration of that situation, which we know is typical, in which there is a wide difference in the costs of different members of the same industry. Those at the lower end of the profit scale may be incurring losses, while those at the upper end may be making sufficient profit to stimulate their production of all that the market will absorb at prevailing prices. In this case there is a grave question whether the marginal concerns should be saved by widening their profit margins through wage reductions or increased prices, when the alternative is to concentrate production in the more efficient concerns.

A third consideration is more general in character. If we think of the economic system as a whole, it seems to me that any distinction between what Professor Slichter calls cost-determining prices on the one hand, and selling prices on the other, becomes illusory. What is cost to one is price to some one else.

If you increase one profit or income, you decrease another, unless general expansion is occuring. It is a contradiction in terms to reduce costs while keeping up selling prices, for everybody at once. We therefore get back to the fundamental problem of the correct relationship between prices and classes of prices—a problem recognized in theory at the beginning of Professor Slichter's paper. The most familiar aspect of this problem is the disparity between agricultural and industrial prices. In order to correct this, it proved both impossible and unjust to labor in a time of depression to raise agricultural prices enough to close the gap; the conclusion therefore is that industrial prices as a class or an average ought to come down. Within industry itself there are prices that for similar reasons ought to be treated differently. There are some groups, such as steel or other building materials, in which the principal need was larger sales and production, possible only at lower prices, and in which, with large sales, profits would probably be at least adequate without wage reductions. There are other groups, such as clothing or some branches of textiles, where it is probable that even with the largest possible sales, prices were, at the bottom of the depression, too low to allow the payment of adequate wages.

There is the further question whether even an ideally perfect price readjustment would automatically bring recovery from depression, if there were lacking at the same time a general program of production which would assure larger sales to those whose prices were reduced. This is too intricate a question to examine here, but it may suffice to point out that the market for the goods of many whose prices ought theoretically to be cut is not elastic, at least under depression conditions. This fact no doubt prevents industrialists from taking the good advice so freely proffered them by economists.

The general conclusion from these comments on Mr. Slichter's paper reinforces the feeling expressed both by him and by Dr. Hinrichs that we are not prepared, either politically or technically, to engage in authoritative national planning of economic affairs. We need much more careful and continuous investigation before we know enough technically to elaborate a program. Any such program would hit so many vested interests that it would be blocked, under capitalism. Even the moderate suggestions of Professor Slichter are probably unworkable. But when it comes to control of specific prices, wages, and production, the desirability of which I have outlined, the task is obviously beyond our present political competence. We need a definite objective, and we need political support of that objective, in all its ramifications. Those whose stake is in capital return will now support reduction of wages but not of interest. Those whose stake is in wages will act in contrary fashion. Even Professor Slichter has not defined his objective very carefully. Apparently it is recovery, but what is meant by recovery? Merely a revival of business profit in the midst of a large pool of unemployment? Merely a temporary upswing of the business cycle, to be followed by another crash?

This leads us to Dr. Hinrichs' paper. Because we are at present unprepared, does that mean we should do nothing to press forward toward the changes in our economic system that obviously are necessary, until another disaster makes possible a genuine new deal? That is unwise, and also impossible. The social forces making for change are insistent and will demand experiment. At the

present time there are several bills pending in Congress for planning agencies. It is important to know what kind of agency would be useful.

I should hope for legislation defining a general objective for planning much as Dr. Hinrichs has defined it. The board set up ought for the present to be purely advisory, and should be an independent agency of government, not directly subject to the President or Congress. Its members should be chosen for competence in the task rather than as representatives of interests. Nevertheless we should expect them to be biased for one interest or another. We should therefore require them to submit alternative programs, and if a division of opinion developed in the board, provision should be made for the publication of minority reports.

Such a board should have the duty of making periodic reports to the President and Congress, setting forth concrete policies and programs by which the general objective defined by Congress could be approached, and it should assess statistically the progress toward, or retrogression from, the attainment of this objective. It should also, on request by Congress or the President, give advice concerning specific legislative or executive proposals, in the light of the major objective and its implementation of this objective by concrete programs.

I should not expect such a board to produce much concrete benefit in the operation of capitalism. It would, however, increase technical competence in economic planning, and by defining and posing issues more comprehensively and more sharply, it would aid the political preparation for a genuine and operable change in the system.

HARRY W. LAIDLER: I find myself in agreement with Dr. Slichter in his belief that government spending and unemployed benefits might profitably be used in assisting in economic recovery. I feel that the arguments of Dr. Slichter against wage cuts as a means to recovery are far stronger than those in their behalf. It is an exceedingly difficult thing to decrease the rates of wages, and at the same time to prevent the decrease of total wage income.

In any discussion of wage cuts, we must not lose sight of the fact, as I am sure Dr. Slichter does not, that the vast majority of wage earners spend practically all of their income immediately on consumption goods. Brookings Institution brings out the fact that families with incomes of $2,000 or less saved but 1.6 per cent of the total income, and that the 60,000 families at the top of the income scale, with incomes in excess of $50,000, saved almost as much as the 25,000,000 families having incomes less than $5,000.

If we want to keep up purchasing power during a depression, we should see to it that the lower income groups who depend for their income largely on wages retain whatever purchasing power they may have acquired. We must also realize that, even during good times, wage rates are so low that a majority of families have an income insufficient to permit them to maintain a standard of health and decency; that, during a depression, thousands are employed on only part time; that those fully employed are burdened with the maintenance of relatives and friends who are out of jobs; and that, in a depression, the tendency is to increase industrial productivity per man-hour even more than in prosperous times. From 1929 to 1934, the National Bureau of Economic Research shows that productivity per man-hour in manufacturing industry advanced by about 25 per cent.

Dr. Slichter's analysis in general indicates the extreme difficulty of guaranteeing to the masses under capitalism either security or decent living standards, and provides a further argument in favor of an advance to a planned society.

I agree with Dr. Hinrichs that we should regard stability as a dynamic, not as a static concept; that, before we plan, we must be clear in regard to objectives of social planning as well as the means to be employed in attaining these objectives; and that genuine social planning involves the fullest utilization of our resources for the common good. If we are to avoid international instability, we must, of course, develop a plan that takes into consideration the advancement not only of one nation, but of the world; a plan that steadily reduces the economic frictions between nations. I agree with Dr. Hinrichs that social-economic planning should not be confused with the limited planning which we have thus far seen in particular industries and services, each service planning with little or no relation to the development of other services or industries.

I favor the plan of Dr. Hinrichs for the establishment of a government research agency engaged in the task of appraising the extent of our potential resources and the needs of the American people. I doubt whether, under our present governmental set-up, a legislative reference bureau engaged in evaluating proposed legislative measures would be very helpful. As Dr. Hinrichs suggested, these agencies would be subject to many pressures. An effort would be made to appoint those whose social outlook and political biases were similar to those of the party in power, and the judgments of these economists as to the political wisdom of a measure would have to be based quite as much on their estimate as to what was politically expedient as on what was economically practical. These judgments would involve opinions as to what economic institutions and motivations were likely to bring into play the maximum industrial efforts, judgments that require more the service of social psychologists than of economists.

In the meanwhile I am firmly convinced that economists should grapple with the problem as to whether it is possible fully under capitalism to utilize the productive resources of the nation with a view of giving the American people the highest possible material and cultural standard of living, or whether we must not advance to a co-operative social order.

Under private capitalism, with its trends toward monopoly, our economic system is becoming increasingly insecure. We cannot depend, as in the past, on the settlement of new portions of our country to keep our industry going. Our frontiers have been pushed back to the Pacific Coast. We cannot depend, with our ever greater foreign competition, on the continual expansion of foreign trade. Our population is ceasing to grow as in former days. Our price system, as Dr. Gardiner C. Means has brought out, is becoming ever more rigid and inflexible, and does not respond as formerly to changes in the demand for goods. Our extremes of wealth and poverty are great. Our debt structure, as the Twentieth Century Fund brought out, is much higher than before the World War. For every $1.00 of debt we carried before the War, we carried $3.52 in 1932. After a major depression, with our mass production, it takes a shorter time than in the past to saturate the markets with goods. The proportion of durable and semidurable consumption goods is increasing in modern industry as compared with perishable consumption goods, as Dr. Frederic C. Mills, of the National Bureau of Economic Research, has so clearly brought out. And, as is well known,

the fluctuations in durable goods production are far greater than those in nondurable goods. In the years 1927 to 1929, durable goods production, for instance, increased by 19 per cent and then declined to 1932 by 66 per cent, while nondurable goods rose in quantity during this predepression period by 11 per cent and declined after the crisis by the same ratio. And our technological changes are increasing at a faster rate than in past days. All of these factors are making for increased insecurity, and necessitate a fundamental change in our economic system.

We cannot go backwards. As Dr. Hinrichs brings out, a free market is only a passing phase in our economic structure. In a country where two hundred large corporations control about half of the wealth of the industrial corporations of the country; where, in industry after industry, one, two, three, or four giant combines sell a major part of the output in their respective fields; and where there are increasing price agreements between corporations organized in trade associations and other types of organizations, a free market is a chimerical dream. We cannot obtain economic stability of the type defined by Dr. Hinrichs by permitting each industry to plan under the profit system. Such planning would almost inevitably mean high prices, restricted production, and the continuance of a scarcity economy rather than low prices and the maximum utilization of production. And stability of that type in one industry, such as steel, would mean increasingly instability in other industries, such as automobiles, construction, mining, etc., which are dependent for their existence on a continuous and cheap supply of steel.

Social-economic planning with a view to stability and the maximum utilization of our resources for the common good must extend beyond the boundaries of one industry. It must embrace all essential industries. It must be a national, rather than a one-industry plan. And the purpose of that plan must not be the maximum profits of each constituent unit, but the general good of the community-at-large. This ideal cannot be attained under a system of private ownership. It is impossible for a community to direct the economic processes of tens of thousands of individual plants which the community does not own. Genuine control comes only through ownership. A planned society for stability as defined by Dr. Hinrichs thus implies the social ownership of the basic industries of the country.

Attempted planning under capitalism, as a Russian statistician brings out, is likely to lead to constant friction between the class groups represented on the planning bodies; similar conflicts between individual employers and the development of an expensive bureaucracy intent on superimposing certain regulations on thousands of individual units run for private profit.

Under a co-operative planned society every effort must, of course, be made to plan democratically; to institute in each socialized industry a system of functional representation under which consumers, workers, and technicians will be adequately represented on the governing boards; to decentralize control as much as is consistent with the best utilization of the resources of the country and to insist on the preservation and the extension of civil liberties. Such a planned society should mean the utter elimination of the autocratic and dictatorial control found in such a monopolized and quasi-monopolized industry as steel. It would necessitate an enormous development of scientific research in connection with individual industries and with the central co-ordinating body. It would require

constant experimentation in better methods of administration. It would require the development of varying types of public industries, probably the very considerable development of the corporation form of public industry, with its greater flexibility of management than is found in the departmentalized form of public ownership. And it would require the development of international planning groups, the success of which would largely depend on the degree to which other countries were socialized.

Many opponents of planning take it for granted that planning presupposes autocratic control. That planning does not need to be autocratically superimposed in a collectivist society even under a proletarian dictatorship is indicated by some of the procedures adopted in Russia in developing its Five Year Plan. The general purpose of the plans were set forth by the government; namely, the construction "of a socialist society on the basis of the maximum development of productive forces and the systematic improvement of the condition of the workers."

The government indicated a number of ways in which, in its opinion, the plan could be developed. It set forth certain standards and indicated the chief branches in which new capital was required. Finally, it determined the general policy of prices and wages and of how consumption power should be distributed. The government memoranda, however, did not contain any detailed figures. The Gosplan took these general memoranda. It worked out, on the basis of information acquired from all parts of the country, a detailed blueprint of production. It passed its blueprint on to all departments of the Soviet government, to all republics and districts. From there the blueprints were distributed to the public corporations, trusts, and other industrial and social groups where they were discussed from all angles in heated meetings participated in by managers and workers. Sometimes the workers and technicians decided that the increase in productivity suggested was too high, and urged that the figures be revised downward. Sometimes the reverse was the case. The counter-plans were returned to the planning boards in the various industries and from there to the Gosplan. The Gosplan talked over these suggestions with various industries and revised their plan, submitting their revised plans to the government. The government thereupon submitted the matter to the country. If such democratic procedure were adopted under a collectivism that frankly admitted a considerable degree of dictatorship, surely democratic forms of planning could be looked forward to under a consciously democratic type of collectivism.

It is the task of the economists to think through a system of planning which promises to bring about stability along the lines suggested by Dr. Hinrichs and to combine stability with democratic procedure.

If they conclude that economic stability is only possible under a socialized system, is it not their task to state their conclusions frankly, even though these conclusions run counter to the prejudices of the American people in favor of the status quo, prejudices, however, which are steadily disappearing in the face of increasing insecurity? Is it not also the task of the economist to point out ways and means of attaining that dynamic stability through the organization of the great majority of the people in economic, political, co-operative, and educational organizations? That, of course, as Dr. Hinrichs brings out, verges on the field of politics. But we cannot continue the present drift toward increasing

instability, with its increasing dangers of chaos, dictatorship, and war. We must not seek to adjust ourselves to instability, but build toward a stable and secure civilization.

EDUARD HEIMANN: My discussion will be confined to one substantial point which I will introduce and conclude with a few remarks of a more general character.

While I heartily approve of the objectives as set forth in Dr. Hinrichs' paper, it seems to me that it presented rather an administrative program than an approach to the inherent economic problems. It contained no positive reference to such things as evaluations or prices or accounting. I am sure Dr. Hinrichs excluded them deliberately from his presentation because those other things appear more important to him. Yet I firmly believe that we, as economists, have to penetrate the huge body of interrelated economic activities with some objective measure, in order to find out whether, why, and how far a plan is justified, instead of abandoning it all to the arbitrary and uncontrollable decision of a benevolent administration, whatever its political basis.

That is why Dr. Slichter's approach to our problem appeals more to me, for methodical reasons; that is, for reasons of scientific analysis. He describes the acting forces, the acting of these forces, today under the stimulus of profit. As far as I understood, he would not assert, and I certainly would not assert, that these same forces must continue for ever and always in the same way. The fundamental point is rather the methodical analogy. Something analogous to their working, something technically similar, will be needed in any system to come. It is of course true that profit is no trustworthy indicator of real demand. However, it seems to me, it is almost more important to stress that after all, profits have something to do with prices and prices, much as they may be manipulated, have something to do with demand—they fluctuate as a consequence of fluctuations of demand, they are expressive of relative satisfactions, of course within the limits of the given structure. What a discussion of planning should examine is the question how this price mechanism would work in a different structure, with partly or totally different institutions, within the same or a different property and income stratification.

Now to come to my point. Dr. Slichter made a rather unusual statement in saying that the present system is nearly always on the verge of shrinkage and held back only by new discoveries. To put my point as bluntly as necessary within these few minutes it seems to me that this statement, striking as it is, is still too optimistic. The remedy itself, the new discovery, need not necessarily but may easily become a menace to the stability of the system and the maintenance of the volume of production and income. The discovery results in eliminating factors of production from present use. This will probably not happen in the pioneering enterprise itself which may increase its output, but the larger supply and lower price will displace marginal factors of production either in the same industry, if demand is inelastic, or in some other fields, if demand for the product of the progressive industry is elastic. Now it cannot be argued that the displaced factors would be reabsorbed at once because of the lure of profit. The elimination of the factors and saving of their remuneration is itself identical with the emergence of the new profit but it is a very different question whether this profit can be invested. Prerequisite to its investment is the visible existence

of an additional demand for whatever product. The mere spreading of the discovery may solve the problem for the private aspect and for the time being by using the profit for the construction of more such labor-saving instruments, but would obviously intensify the evil. As no additional demand arises as a consequence of the discovery, the rational-minded business man has to hoard his profit. This is what the logic of the situation requires him to do and what economic theory deduces as the probable result as economic theory has to describe and to condense the logic of men's reactions to various situations.

This deduction is not in contradiction to the classical principles as it starts from different assumptions. The price system equilibrates under static conditions where the one man's loss is the other man's gain and the entire rearrangement is induced by a preceding shift of demand from the one to the other. Under these conditions the rearrangement has merely to follow an existing price signal. Under our dynamic conditions there is no such lure to investment. The elimination of the first group of factors from employment and income deprives a second group of factors of their customers; this again affects a third group; and so on down to the complete destruction of the circular flow.

Now this does not usually happen. However, the logic of the discovery itself tends to lead to the self-destruction of the system, and if this result is avoided, it is due only to the historical coincidence with other independent movements, not to a logically necessary connection between the destructive and the compensating force. The coincidence is abandoned to mere chance; there is no guarantee. This constitutes the case for planning: a deliberate intervention to secure the equilibrium is required wherever the logic of the spontaneous activities fails to provide for the equilibrium.

This train of thought (whose elaboration is owed to Adolf Loewe of the University of Manchester, England) starts from a technological assumption as an interference which the system cannot remove nor dissolve. As such it is of course independent of the economic and social order. What distinguishes the different economic orders and institutions is their capability of meeting the difficulty. That is where I disagree with Dr. Slichter. The task is not definable, still less solvable, in monetary terms alone, such as the investment of capital, the interest and profit calculation, etc. For the stability of the system as a whole it makes all the difference in the world whether a given capital is used to mechanize existing jobs with the potential effects discussed before, or whether this capital is used to erect additional plants and additional jobs. For the capital market and the interest rate this makes no difference at all, which proves the inadequacy of the merely monetary terms to meet the situation. They remain always indispensable but they need to be supplemented by a qualitative analysis of the dynamic change in technological and labor terms.[1]

In conclusion, I want to emphasize the idea expressed by the chairman. There is no true contradistinction between planning for stability and adjustment to instability. In either case the same stabilizing methods are required. The thing to do is to find out the potential and actual grounds of disturbances and to insert a compensating force to the system. The more effectively this is done, the more would we pass beyond a mere adjustment to instability and would attain a real dynamic equilibrium.

[1] Eduard Heimann, "Planning and the Market System," *Social Research*, November, 1934.

TRANSPORTATION PROBLEMS

I. L. Sharfman, *Chairman*

Two major problems received consideration in this discussion: transportation co-ordination and the financial condition of the carriers.

The basic elements of the problem of co-ordination were presented on behalf of Mr. J. R. Turney, of the Office of the Federal Co-ordinator of Transportation, in the form of the following five propositions: 1. Exploitation of transport facilities is a public and not a private franchise, and hence, a carrier has no vested right in advantageous traffic location; and it must operate its facilities in conjunction with those of other carriers and where necessary to attain efficiency, service, or economy in subordination of its private advantage. 2. Competition in transport service and efficiency is inherently beneficial, provided there are eliminated attendant evils, such as competition between different kinds of carrier agencies, between carriers designed to promote competitive markets, in pricing or rate-making, and in unnecessary duplication of service, plants, or accessorial facilities. 3. Rail operations should be designed for inter-carrier traffic rather than local traffic, in view of the predominance of the former, by integrating the pricing function in a single carrier agency, and eliminating promiscuous and multifarious routing. 4. Co-ordination of rail, water, highway, pipe line, and airway carriers should be designed to provide the best service at the lowest price possible through utilization of each agency in the sphere of its economic superiority by basing prices of any service upon the cost of providing that service by the use of the most efficient agency or combination of agencies, and eliminating the "by-product" theory from rate-making. 5. To attain the flexibility and economy necessary to meet the rapidly growing menace of private transport carrier facilities, service and schedules should be unified to bring about superior service most economically by making the facilities of all carriers of all types available to all other carriers, avoiding unnecessary duplication of present facilities, substituting the service of one type of carrier for that of another wherever desirable, such as by motorization of branch lines or in terminals, and elimination of interchange wastes by unification of terminals at junctions and gateways.

Most of the discussion was concerned with the various aspects of the problem as thus presented. Commissioner W. M. W. Splawn, whose comments were read because of his unavoidable absence, argued against "the so-called planned co-ordination imposed by political authority." His position is indicated by the following:

> Considering the vast expanse of the continental United States, the great differences in density of population and of traffic, the intense rivalries between domestic markets, the differences in the status of shippers from that of the individual natural person who occasionally sends a parcel by post to the corporation which distributes its products in every community and considering the differences in the standard of living, particularly in the expense of maintaining a given standard of living from one locality to another, we can perhaps look for best results in the continuation of the evolutionary processes through which we have been passing and which are characterized by many private companies, each undertaking to serve its particular constituency in the light of its peculiar development.

Professor W. J. Cunningham was skeptical of the feasibility of eliminating the so-called "by-product" theory of rate-making, and he expressed regret that Mr.

¹Eduard Heimann, "Planning and the Market System," *Social Research*, November, 1934.

Turney was not present to develop his proposal. Professor C. O. Ruggles directed attention to the outstanding significance of the terminal problem in the achievement of desirable co-ordination, and while arguing for fair treatment of the existing owners, he expressed the view that unification of terminal facilities was indispensable to any sound and economical adjustment of transportation relationships.

Professor D. P. Locklin directed attention to the controlling importance of rate policy in the matter of co-ordination, arguing that as a general rule each agency of transportation should be made to adhere to rates based on the cost of its own service, but recognizing that under competitive conditions certain qualifications may be necessary in the public interest. Professor T. C. Bigham and Professor G. L. Wilson placed special emphasis on the difficulties of cost determination and the necessity of departing from so-called "scientific" formulas in rate-making. Dr. C. S. Duncan and Dean C. L. Raper emphasized the obstacles to co-ordination created by the existence of surplus facilities; and Dean Raper found Mr. Turney's basic concept that "exploitation of transportation facilities is a public and not a private franchise" too sweeping a one for the railroads in the United States.

The analysis of the financial condition of the carriers was presented by Professor L. C. Sorrell. Taking 68 roads or systems which operated in 1935, about 95 per cent of the mileage operated by all Class I carriers in that year, he found that during the five-year period, 1930-34 inclusive, 15 (operating 25.6 per cent of the mileage) earned their fixed charges in every year; that 3 (5.4 per cent of the mileage) failed to earn their fixed charges in one year only; that 4 (9.4 per cent of the mileage) failed in two years only; that 17 (24.6 per cent of the mileage) failed in three years; that 11 (19.0 per cent of the mileage) failed in four years; and that 18 (16.0 per cent of the mileage) failed in every year. After combining this earnings-fixed-charges situation with that relating to maturities for the period 1935-40, he concluded:

> As a rough approximation it seems fair to say that about one-third of the mileage is still in good financial condition even after six years of severe depression, another third is in poor condition and seems to need drastic reorganization, and the remaining third is in a condition to benefit markedly from a moderate upturn in business and could recover financial health. While some elements of weakness yet are found in the strong and intermediate groups, the depression seems to have shaken down most of the weak carriers into the receivership group.

While there was little controversy as to the facts presented, Professor Cunningham expressed the view that with continued improvement in railroad traffic, the outlook for the railroads was a more favorable one than seemed to appear from Professor Sorrell's analysis.

FIFTY YEARS' DEVELOPMENTS IN IDEAS OF HUMAN NATURE AND MOTIVATION

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I

Some years ago an eminent member of this Association began an article with the remark that it would be rather bold to include among the unsolved problems of economics the fundamental nature of the cosmos. Doubtless it would. Neverthless, the science of economics must include the original nature of man among its major and constant preoccupations. Indeed, it has always done so, as every student of the subject knows. The science was founded upon the assumption of a human nature so construed as to give rise to "truck, barter, and exchange," the division of labor, enlightened self-interest, and so forth; in short, a conception of human nature of which the pecuniary system seemed to be a natural expression. Any critical discussion of the classical principles of political economy must therefore take cognizance of the theory of human nature from which those principles emerged. Presumably, this is no less true of the economics of the last half-century. Whatever its form and preconceptions, economics is necessarily a description, an analysis, and even it may be a prediction of human behavior; and consequently it cannot avoid being affected by any important development in the study of human nature.

So we say. But in fact, precisely how has economics been affected? The past fifty years have brought psychological novelties galore. Looking back a bit we see structuralism, functionalism, and dynamism, behaviorism, psychoanalysis, and now *gestalt*. But what has economics learned from all these "isms"? Briefly, nothing. The same is true of social anthropology. Half a century covers the whole life span of this lusty infant, and for most of this time economists have been telling each other that we have much to learn from the analysis of cultures. In recent years, "Study anthropology!" has become the party slogan of at least one group of economists. But even the most enthusiastic student of comparative culture traits would be stumped if he were challenged to cite any one specific economic problem to the solution of which anthropological data or methods have made a specific contribution.

This paradox is capable of various resolutions. One is that economics absorbed a great deal of psychology in the eighteenth century but has learned nothing since. Another is that for all the fuss and fury of contending schools, modern psychology has nothing in particular to say. Both of these opinions are widely held. But both seem to me to miss the point. Are the sciences all related in precisely the same fashion? We know that the

physical sciences do make specific contributions to the solution of each other's problems. The automic numbers worked out by a chemist are promptly seized by the physicists and applied to the analysis of the orbits of electrons. The data of the physicists concerning the emanations of radio-active substances are directly applied by geologists to the measurement of geological processes. The chemical technique of spectroscopy revolutionizes the study of the stars, etc., etc. It is quite obvious that no such reciprocity links economics to the study of human nature. No catalogue of reciprocal contributions can be made because no specific exchanges, such as those between chemistry and physics, have occurred.

But that is not the basis upon which, as everyone knows, eighteenth century economics was closely linked with the eighteenth century conception of human nature. Adam Smith's celebrated instinct to truck, barter, and exchange was not a specific discovery of contemporaneous psychology; nor was any other figment of classical economic theory. What economics shared with the psychology of that day was a point of view—a set of preconceptions. If we still read Smith's *Theory of Moral Sentiments* and Hume's *Treatise on Human Nature,* it is not to trace specific discoveries but to accustom ourselves to the "climate of opinion," as Professor Becker calls it, in which economics once flourished. This is no less true of the literature of the past half-century. No one doubts that the nineteenth and twentieth centuries have brought important if subtle climatic changes, and surely no one would question the importance of these changes for economics or for psychology or even the reciprocality of such climatic adaptations as have occurred in the study of economics to those which have occurred simultaneously in psychology and anthropology. The significant relation between economics and the other studies of human nature and behavior and culture can be discovered only in this common and mutual adaptation.

II

Throughout modern times the whole study of human behavior, of which economics is a part, has undergone profound change. This change is, of course, in the direction of secularization. Economists have often expostulated over the excessive rationalism of the eighteenth century, and it is certainly true that mankind is not the perfect calculator of classical theory. But this criticism, just as it is, has tended to magnify the rationalism and thus to obscure what philosophers call the empiricism of the eighteenth century economists and moralists, which was after all their principal achievement. The economic man may have been a bit of a prig, but he was nevertheless a creature of sentiment and instinct, a sentient organism rather than a spiritual being, a figment of natural history rather than of theology. As Leslie Stephen remarked in one of his most luminous passages, what the eighteenth century empiricists were about can be understood only if we

bear in mind that the Divine Presence had already receded beyond human ken, so that the moralists and economists of that modern day were confronted with the task of accounting for such orderliness as human society exhibits in terms of explicitly secular connotation. Although, of course, he did not and could not follow it up, Adam Smith's reference to language behavior as the possible matrix of all social activity is extraordinarily significant. By intent, Adam Smith was quite as much of a behaviorist as John B. Watson, and in this regard economics has suffered no serious lapse from scientific grace. That is, there has been no important and continued reversion toward the prescientific treatment of human nature. On the contrary, the whole drift has been toward the analysis of human nature and behavior as that of an animal species different from other animal species only in matters of detail and degree.

Nevertheless, the march of science has not been unencumbered. Economists frequently lament the necessity which apparently compels them to use a terminology drawn from popular usage and therefore contaminated with all sorts of popular interests and notions, but they have quite generally overlooked the chief danger to which the science is thereby exposed. It so happens that the social sciences not only deal with matters of public concern but wrestle with problems which have been predefined by this very public interest. Thus the social sciences embody an amazing paradox. They represent the attempt to use a scientific methodology in finding solutions for non-scientific problems. Students often express surprise that Descartes should have proposed to explain the action of the soul in terms of the pineal gland, but what Descartes was obviously doing was attempting to solve a tradition-given problem by scientific techniques of analysis. That is what the study of human nature has amounted to ever since. Surely the reason for the bewildering series of "isms" with which psychology has puzzled the world during the last half-century is to be found in the persistent unamenability of the popular conception of soul, mind, consciousness, self, or personality, to satisfactory analysis in terms of sensations, synapses, reflexes, complexes, or *gestalts*. Judged in terms of intent and method, each new psychology is commendably scientific; considered as a solution of the immemorial mystery of human nature, none is satisfactory.

It is this mystery with which economics has been involved since its earliest days. The paradox is the familiar one of natural order. In that celebrated phrase the word "natural" expresses the determination of careful and tough-minded thinkers to find scientific explanations, while the word "order" poses the popular belief. What is to be scientifically explained is the common conviction that all things work together for good. John Locke was sufficiently realistic to wipe the slate clean of innate dispensations, but the sensations he then proceeded to record were nevertheless calculatd to account for the decorum of the day. As he said, "The infinite wise author

of our being, to excite us to those actions of thinking and motion that we are capable of, has been pleased to join to several thoughts and several senses a perception of delight."[1] The happy conjunction of pleasure and pain with social order and disorder was immediately identified by Bernard Mandeville as the "simple and obvious system." "This is the Law of Nature," he wrote, "by which no Creature is endued with any Appetite or Passion but what directly or indirectly tends to the preservation either of himself or his species."[2] As a physician, perhaps, Mandeville could be cynical about the beneficent public function of private vices, and his scurrility was an offence to pious nostrils; but as everybody knows, the conjunction of organic process with the public good survived the opprobrium of his description. When Adam Smith sat as a student under the devout ministrations of Francis Hutcheson, that worthy was asserting more vigorously than ever that there is "a general Good amidst all the private Interests," and exclaiming, "How clearly does the Order of our Nature point out to us our true Happiness and Perfection, and lead us to it as naturally as the several Powers of the Earth, the Sun and Air, bring Plants to their Growth and the Perfection of their Kinds! We indeed are directed to it by our Understanding and Affections, as it becomes rational and active Natures; and they by mechanick Laws."[3]

In other words, the economic theory of community of interests is a peephole through which the social philosophers of the eighteenth century caught a glimpse, as they thought, of the fundamental nature of the cosmos. Professor Warner Fite once quoted an extraordinary footnote from a century-old American edition of Butler's *Analogy* which bears directly on this point. According to this perspicacious editor, "Hume says, 'though man, in truth, is a rational agent, having all his acts determined by fixed and immutable laws, yet this being concealed from him, he acts with the conviction of being a free agent.' Which is the same as to say that God intended to conceal from men an important fact, involving the whole subject of right and wrong, but Mr. Hume found Him out."[4]

So important was this fact for classical economic theory that it continued to dominate the social philosophy of the nineteenth century as well. In 1831, Whately declared that "there are the same marks of contrivance and design, with a view to a beneficial end, as we are accustomed to admire (when our attention is drawn to them by the study of Natural-Theology) in the anatomical structure of the body, and in the instincts of brute-creation. . . . But I know not whether it does not even still more excite our admiration of the beneficent wisdom of Providence, to contemplate,

[1] *Essay Concerning Human Understanding*, Book II, Chapter 7, Section 3.

[2] *Fable of the Bees*, "Remark R" (edition of 1723, p. 219).

[3] *Essay on the Nature and Conduct of the Passions and Affections* (1728), p. 181, and pp. 202-3.

[4] "Birth Control and Biological Ethics," *International Journal of Ethics*, XXVII, 52.

not corporeal particles, but rational free agents, co-operating in systems no less manifestly indicating design, yet no design of theirs; and though acted on, not by gravitation and impulse, like inert matter, but by motives addressed to the will, yet advancing as regularly and as effectually the accomplishment of an object they never contemplated, as if they were merely the passive wheels of a machine. If one may without presumption speak of a more or a less in reference to the works of infinite Wisdom, I would say, that the branch of Natural-Theology with which we are now concerned, presents to the reflective mind views even more striking than any other. The heavens do indeed 'declare the glory of God'; and the human body is 'fearfully and wonderfully made'; but Man, considered not merely as an organized Being, but as a rational agent, and as a member of society, is perhaps the most wonderfully contrived, and to us the most interesting, specimen of divine Wisdom that we have any knowledge of."[5] Economists read such remarks with a quiver of disapproval nowadays, and for that matter Hume would have done the same. Nevertheless, scarcely more than half a century ago it was still possible for an eminent economist to have "dimly discerned" in the economic theory of self-interest "one increasing purpose" of what he did not hesitate to call "the Divine idea." "As the movements of each particle, constrained or loose, in a material cosmos are continually sublimated to one maximum sum-total of accumulated energy, so," he thought, "the movements of each soul, whether selfishly isolated or linked sympathetically, may continually be realizing the maximum energy of pleasure, the Divine love of the universe."[6]

III

I have labored this point somewhat and have even risked arousing the antagonism of my hearers by citing rather extreme cases because the matter is of major importance to an understanding of later developments. It does not follow that economics is a branch of "Natural-Theology" because Whately said it was, or because later economists have occasionally indulged in devotional expressions. But the continuity of the intellectual purpose for which such expressions are employed is very striking. Hutcheson, no less than Edgeworth, proposed to treat human motives as natural phenomena like "particles, constrained or loose," directed by "mechanick Laws"; but Edgeworth, no less than Locke, traced the realization of "the maximum energy of pleasure" to the "perception of delight." Like Hume, the classical economists pretty generally avoided devotional expressions. But no less than Hume they regarded human nature as a peep-hole upon the fundamental nature of the cosmos. Theirs was a theory of economic order which was natural precisely because it was an expression of the natural propensities

[5] *Introductory Lectures on Political Economy*, pp. 108-10.
[6] H. Y. Edgeworth, *Mathematical Psychics*, pp. 11, 12.

of human kind. The concern of the economists was, of course, with secular manifestations, but always, nevertheless, with the secular manifestations of that "wonderful contrivance, man, considered not merely as an organized being but as a rational agent."

With the advance of science the economic treatment of these secular manifestations, of course, became increasingly abstract and even mathematical, and in doing so it ran closely parallel to the development of psychology. Exact measurement and mathematical formularization made rapid progress in the physical sciences during the first half of the nineteenth century. Simultaneously, a great deal was learned about the nervous system, especially about the enervation of the sense organs. It was therefore quite natural, perhaps, that scientists such as Weber and Fechner, trained in the physiology of the nervous system, should pitch upon sensation as the elemental component of the psyche and should seek to isolate and measure the psychic atom (or cell) by experimental methods much the same, presumably, as those of physics and histology. As everyone knows, modern experimental psychology was born of this attempt. In similar fashion, economic theory also assumed the mantle of science, and—what is most striking—it did so by an attempted isolation, measurement, and mathematical formularization of psychic atoms. This analogy has been noted and discussed by various economists and psychologists,[7] and it seems to be pretty well agreed that the two developments were independent, though both were, of course, stimulated by the same atomistic and mathematical trends, and that the economic atomization of wants and utilities is not necessarily contingent upon the validity of the Weber-Fechner law for the atomization of sensation. But both, nevertheless, assume the existence of a psychic entity or substance which is subject to dissection and of which therefore both sensations and want-utilities are presumed to be component parts.[8] Thus the neo-Classical school in economics and what might also be called the neo-Classical school of Ward, Stout, and Titchener in psychology, both attained the form of exact sciences by the minimum-perceptible-dose technique of measurement and mathematical manipulation of what for both was admittedly psychic content.

IV

In this fashion both economics and psychology embarked upon the past half-century equipped with a method and a dogma. But for each, in spite of its brave show of mathematical technique, the dogma proved embarrassing. Precisely what was the object of all this complicated analysis? The

[7] Recently, for example, by Z. C. Dickinson, *Economic Motives*, pp. 232 ff., and A. J. Snow, "Psychology in Economic Theory," *Journal of Political Economy*, XXXII, 493 ff.

[8] This is particularly obvious in the case of Jevons who unblushingly cites Pascal's supposed measurement of doubt and belief as a case in point, and derives support from avowedly theological writers such as Hutcheson and Paley.

progress of science had made it increasingly difficult to reply, as Jevons or Hutcheson would have done, "Why, the feelings of the human heart."[9] Something required to be done to make the object of analysis of both sciences conform to a more sophisticated notion of scientific objectives. In both sciences this endeavor took two forms. First and most obvious was the proposal to give the object of analysis a nicer scientific name. This maneuver in psychology led to the complete abandonment of all reference to the soul, and even to the substitution of consciousness for mind, and of awareness for consciousness, and of experience for awareness, etc. By a similar maneuver economists simultaneously agreed to abandon all reference to hedonism and to substitute unpleasantness for pain, and satisfaction or gratification for pleasure, and so forth.[10]

But the resolution was not made so easily. It was perfectly obvious for all their cautious language that the psychologists were still engaged with the anatomy of the soul,[11] and that the economists were still dealing with Mandeville's "creature endued with appetite and passion." A more complete and convincing disavowal of the classical objective was clearly called for. This of course raised the question whether, lacking their original objective, the neo-Classical theories could still be pursued along the familiar lines. Both in psychology and in economics the paradox was resolved not by a solution of the intellectual problem but by a course of action. Orthodox psychologists simply disclaimed all belief in the existence of a psychic entity, while continuing nevertheless to impute separateness and priority to "mental states";[12] and economists, disavowing all concern with the nature of wants, continued to elaborate price theory as a system of want-fulfillment. For orthodox theory, indeed, it was a case of Hobson's choice, as Professor Mitchell has clearly exhibited. "Since hedonism is unsound, either we must admit that both the classical and the marginal analyses are invalid, or we must argue that the hedonistic preconceptions must be given up without compromising the validity of the analysis. The latter horn of the dilemma is chosen. Then we must choose again between providing a sounder psychological basis for our analysis, and holding that its psychological basis does not concern the economist. Again, the latter course is generally preferred. Thus economic theory is said to rest upon the simple facts of preference

[9] Jevons offers this formula with some hesitation, but he offers it nevertheless. *The Theory of Political Economy* (fourth edition), p. 11.

[10] Professor Mitchell once published a glossary of these substitutions. See "The Role of Money in Economic Theory," *American Economic Review,* VI, Supplement, pp. 140 ff.

[11] To mention an extreme case, Professor McDougall, whose denunciation of the psychological assumptions of classical economics had been hailed by some economists as a deliverance from Egypt, was all the while an ardent psychical researcher and avowed believer in the existence of soul-stuff in complete detachment from the physical organism.

[12] Thus "Modern psychology knows nothing of a permanent mind, or of faculties or activities or manifestations of such a mind." E. B. Titchener, *A Text-Book of Psychology,* p. 267. And yet, "However much different schools may vary in their definitions of mind, they agree in this premiss of separateness and priority." John Dewey, *Human Nature and Conduct,* p. 84.

or choice, and the psychological explanation of these preferences or choices is said to be a matter of indifference to our science."[13] The result is what Professor Mitchell has elsewhere called "non-Euclidian economics,"[14] which, in the words of one of its leading exponents, "is not a descriptive, or an explanatory, science of reality," but "deals with ideal concepts which are probably as universal for rational thought as those of ordinary geometry."[15]

V

In the meantime, the whole scientific setting of human behavior has changed. This has been due to many things. For one, the organism is now understood to be a very much more delicate and subtle mechanism than would have been thought possible a couple of generations ago. At another point the study of psychoses, dreams, the development of children, and other regions lying beyond the conventional limits of the older psychology has greatly enriched our understanding of what lies within those limits. But most of all, research in the field of comparative cultures by modern sociology and especially by the new science of social anthropology has resulted in a new appreciation of the meaning of culture and so has laid the basis of a new conception of human nature itself.[16]

The response of orthodox psychologists and orthodox economists to this greatly enriched and expanded understanding of human behavior has been to exclude it from the conventional field. In psychology this has been done by means of a distinction between psychology "proper" and what is called "social psychology," a device which enables psychologists to dabble with the new materials without abandoning their old objective or substantially revising their old preconceptions. And economics has achieved the same comfortable resolution. The new material is too extensive and too interesting to ignore. As Professor Mitchell remarked twenty years ago, "When economic theory has been purified so far that human nature has no place in it, economists have become interested perforce in much that lies outside their theoretical field."[17] The fence outside which all these exciting and dangerous ideas lie is of course that of static theory. Some years ago, Professor Dickinson, representing the orthodox point of view, reached the conclusion "that an accurate knowledge of the psychology involved in economic behavior is needed in economic theory, not so much for static as for dynamic

[13] "Human Behavior and Economics," *Quarterly Journal of Economics*, XXIX, 1, 2. Some economists go even further and declare that wants are unknowable, "the most obstinately unknown of all the unknowns in the whole system of variables with which economic science deals." F. H. Knight, "Ethics and the Economic Interpretation," *Quarterly Journal of Economics*, XXXVI, 455 (Reprinted in *The Ethics of Competition*, p. 20).

[14] "The Rationality of Economic Activity," *Journal of Political Economy*, XVIII, 108.

[15] F. H. Knight, "Economic Theory and Nationalism," *The Ethics of Competition*, p. 277.

[16] For a clear and concise account of the effect of anthropology on the theory of human nature, see Dewey's article on "Human Nature," *Encyclopaedia of the Social Sciences*, VII, especially p. 534.

[17] "Human Behavior and Economics," *Quarterly Journal of Economics*, XXIX, 2.

purposes." That is to say, the old psychology, or no psychology at all, is quite satisfactory for the analysis of price, a deeper understanding of human nature being required only by those who care to look beyond the existing conditions of wants, social structures, and industrial devices and to prophesy what would be the result of various supposed innovations, if they were made.[18]

But there has been another response. Both in psychology and in economics some students have insisted, not without asperity, that their respective sciences can accommodate the new ideas only by a complete overhauling. What most particularly requires overhauling, according to their view, is the objective in terms of which the central problems of both sciences have been conceived. Thus the behaviorists in psychology are not content with adding a few glosses upon accepted doctrines. On the contrary, they denounce psychological orthodoxy in all its forms, however modern in appearance, terminology, or method, as nothing more nor less than a continued attempt to conceive human nature as a psychic entity—that is to say, a soul—and so to pervert the intellectual instruments of modern science to the progressive revision of the ancient spiritual anatomy. To conventional people this denunciation of what has always appeared to be the sole object of psychological analysis seems highly paradoxical. There is a current saying to the effect that modern psychology first lost its soul, then lost consciousness, and now has lost its mind. But this is an appeal to prejudice, and as such it plays directly into the hands of the behaviorists. In their opinion the object of orthodox solicitude can be named in the language of the nineteenth century as mind or consciousness, or in the language of the eighteenth century as human nature, or in the language of the thirteenth century as the soul; but it cannot be named in the language of the twentieth century. Even the term "individual" is regarded with extreme suspicion by the more uncompromising critics.[19]

In similar fashion economics has recently been divided by a schism deeper than any that has ever divided the faithful into sects. Like their psychological colleagues, the economic insurgents are by no means satisfied to follow the by-paths of dynamic peradventure and perchance. On the contrary, they propose to denounce the major assumptions of orthodox theory

[18] "The Relations of Recent Psychological Developments to Economic Theory," *Quarterly Journal of Economics*, XXXIII, 420-1.

[19] Thus Dewey has said, "Any moral theory which is seriously influenced by current psychological theory is bound to emphasize states of consciousness, an inner private life, at the expense of acts which have public meaning and which incorporate and exact social relationships. . . . Every movement of reaction and protest . . . usually accepts some of the basic ideas of the position against which it rebels. So the most popular forms of the clinical psychology . . . retain the notion of a separate psychic realm or force. . . . They still cling to the idea of a separate psychic realm and so in effect talk about unconscious consciousness. They get their truths mixed up in theory with the false psychology of original individual consciousness. . . ." *Human Nature and Conduct*, pp. 86-7.

and most particularly with respect to its objective.[20] It is in this chiefly, I believe, that they make common cause with the behaviorists. As Professor J. M. Clark has said, "In brief, what economists have gained in 'marginal utility' is in appearance a theory of equilibrium and something to gratify the treacherous yearning for a psychic entity which price can be said to measure."[21] This of course involves the repudiation of price analysis, a repudiation that is quite as bewildering to orthodox economists as that of the behaviorists is to orthodox psychologists. It seems to mean the abandonment of all that economics has stood for, and so in a sense it does. The question is, what, after all, has economics stood for? Why has price been its chief concern? In the opinion of the insurgents, the ghost of hedonism still haunts the price analysis of neo-Classical theory. Certainly it is not laid by declaring that wants are unknowable and that the "maximization of want-satisfaction or utility . . . is a simple deduction from the general postulate of rationality of economic action."[22] One can scarcely be rational about the unknowable, or devise a formula for the maximization of whim-satisfaction.[23]

Either wants are stable and known to be stable and reliable guides to human destiny, or no significance whatever attaches to them or to utility or to maximization or to price equilibrium. The economist engages in price analysis because he seeks a theory of economic order. From the distant past he has inherited the idea of a natural equilibrium of forces by virtue of which order obtains among men as it is presumed to do among "particles" and plants. Among the forces which eventuate so felicitously are the inherent qualities of human nature: perception of pleasure and pain, wants and satisfactions, and so forth. Economic theory accordingly presumes that these wants and satisfactions are registered in price, and therefore that price is the mechanism by virtue of which social order reigns. To effect that demonstration is not the sole objective of all price analysis, of course, but it is the sole objective of orthodox price theory. Either price theory is the theory of economic order, in which case it is intelligible only as a refinement of the intellectual means by which social philosophers

[20] As far back as 1918 Professor J. M. Clark declared that "when theory has studied the meaning of value in terms of utility its very attitude and inquiry have presupposed an equilibrium between utilities and have thus been oriented by a static point of view and static assumptions. . . . Not merely the doctrines but the very inquiries (except perhaps the most fundamental), the forms in which they are cast, and the quantitative and systematic character of the results demanded, are themselves dependent on those limiting assumptions from which a fulfilled economics must make itself free." "Economics and Modern Psychology," *Journal of Political Economy,* XXVI, 3.

[21] *Op. cit.,* pp. 21-2.

[22] As Professor Parsons does, following Knight and the Austrians. "Sociological Elements in Economic Thought," *Quarterly Journal of Economics,* XLIX, 432.

[23] As was clearly pointed out long ago by E. H. Downey, "The Futility of Marginal Utility," *Journal of Political Economy,* XVIII, 259 ff., and by J. M. Clark, "Economics and Modern Psychology," *Journal of Political Economy,* XXVI, 19 ff.

have sought to reach an objective which is substantially that of the eighteenth century, or it is wholly unintelligible. Not only do some contemporary neo-Classicists elect the latter alternative, but they seem to make a great point of scientific virtue out of the avowed meaninglessness and pointlessness of their analysis. But the insurgents, following Professor Mitchell,[24] refuse to take this disavowal of objectives seriously. For one thing, nobody could be so passionate in defence of principle or so bitter in retort to criticism merely in the interest of an abstract system of logical postulates. But what is even more difficult to interpret as an expression of scientific aloofness is the felicity of our fundamental institutions and the ill-advisedness of most proposals for alteration as asserted pretty continuously in the writings of the neo-Classicists.

This is where the institutional issue arises. The preoccupation of the insurgents with institutions is by no means merely a broadening of economic interest. Just as the psychological insurgents made behavior the object of their study not by way of broadening the functions of the soul but as a substitute for spiritual anatomy and physiology, so the heterodox economists have proposed to substitute the study of economic institutions for the study of wants, satisfactions, and the wonderful contrivance of human nature as made manifest in the equilibrium of prices. The reason for this is not that orthodox economics is supposed to have overlooked or neglected institutions. Such is, of course, the common opinion. A recent analysis of Veblen's so-called "institutionalism" contrasted it with neo-Classicism by indicating that it transcends the limits of the present institutional scheme, whereas "the Marshallian, on the other hand, conceives the economic problem to be one of making the best of the resources already at hand within the existing framework of institutions." Thus described, "The effort of Marshall and his school is directed to a close analysis of the economic processes conducted under the present social order," and their "proposals for improved economic well-being would be confined to the elimination of elements of friction and disturbance and to the adoption of a program so designed as to bring about the desired results through the working of the existing mechanism."[25] This endows neo-Classical theory with a becoming modesty. But how can this deference to existing institutions be reconciled with the enunciation of abstract scientific laws which are presumed to be true quite irrespective of institutional time and tide? This paradox can be resolved only in one way. The moral philosophers of the eighteenth century believed the institutions of their day to be an expression of divine wisdom as made manifest in human nature, and the orthodox economists of the twentieth century still adhere to this belief; that is, they willingly confine their discussion to the framework afforded by prevailing

[24] "The Rationality of Economic Activity," *Journal of Political Economy,* XVIII, 108.
[25] Karl L. Anderson, "The Unity of Veblen's Theoretical System," *Quarterly Journal of Economics,* XLVII, 421.

institutions because they conceive the institutions to be an expression of human nature. The institutionalists decline to do so because they hold precisely the opposite view of human nature, to wit, that it is an expression of institutions.

That is why the institutionalists are interested in the development of institutions, and not just a passion for the past. And the same is true of machine technology. Orthodox economics has always neglected technology because in the orthodox view of human nature it was only an aspect of a human nature whose much more important aspect was the marvelous equilibrium of prices—the community of interests of the simple and obvious system. The insurgents, however, are not concerned to expand our knowledge of a neglected aspect of a conception of human nature which is to remain sacrosanct. On the contrary, they are obsessed by the importance of machine technology because they see in it a major force by which, more than by anything else, the achievements of industrial society have been made possible, the institutions of the western world have been reshaped, and even human nature itself—if we may speak of such a thing—has been reconditioned and redirected. In the case of technology as in that of institutions, what is at issue is not a minor matter of content but a major matter of objective. For orthodox theory the objective is now, as it has always been, the explanation of social order (price equilibrium) as an expression of human nature (wants and satisfactions); whereas for the insurgents the objective is the explanation of human nature (working, buying, consuming, investing, and so forth) as an expression of the social order (institutions and technology).

VI

In short, institutions mean to the institutionalists precisely what behavior means to the behaviorists, and the reason for this is not that the institutional economists have made use of any specific discovery of the psychological behaviorists but, rather, that two movements are parallel and coincident, as the two sciences have always been. When economics and psychology assumed their positions as distinct sciences, each was presented with a ready-made problem. According to ancient tradition, man is possessed of a soul by virtue of which he is what he is. Psychology began as the attempt to describe this psychic entity in the language of anatomy and physiology. So it was, also, with economics. On the assumption that the "passions and instincts" of mankind had been so designed by the "beneficent wisdom of Providence" as to produce a natural though unintended community of interests, economics undertook to describe this "wonderful contrivance," of course, as a secular phenomenon. Halfway through the nineteenth century, under the influence of atomistic ideology and anatomical research, psychology assumed the form of a full-fledged science by undertaking to dissect the psyche into sensation elements; and at the same time economics

also put on the trappings of science in the form of hedonistic atomism, thereby applying the infinitesimal calculus to the divine beneficence. In both sciences the past half-century has witnessed the appearance of a bewildering series of schools of thought each of which has been intent upon the further refinement of the dissection and elaboration of the supposed component elements of the psyche and its simple and obvious system, though none has seemed to appreciate the extent to which its efforts had been conditioned in advance by the essentially traditional and non-scientific character of its received objective. And finally, in both fields, the twentieth century has brought intellectual revolution. Insurgents have arisen in both to denounce not the techniques of the older schools but the conception of their problem which orthodoxy had inherited from the past and had carried forward from decade to decade virtually without suspicion, and to substitute a quite different conception. In psychology the concept of behavior has been proposed as a substitute for psyche, and in economics institutions and technology have been proposed to replace the price system conceived as a register of wants and satisfactions.

This is the issue of Darwinism. The crucial issue of biological evolution is not that of change but of that which is presumed to change. When Darwin came on the scene species were conceived as fixed, rigid, given once for all, and the problem was how such species could have come into existence. The problem was insoluble except on the theory of special creation for the sufficient reason that species had long since been traditionally defined so as to exclude any other hypothesis. Darwin did not show such species to have evolved; he altered the conception of species. Redefining species as a flexible, shifting, melting sort of thing, he was therefore able to treat it as the product of continuous change. This, I believe, is what Veblen meant when he made Darwinism the crucial issue of modern economics. It is not a question of change but of what changes. Orthodox economists have often insisted, with considerable bewilderment, that they are just as interested in change as anybody else, and that—as for taxonomy—all analysis is taxonomy and theirs no more than anybody else's. This of course is true. But sentiments implanted in the human heart by a beneficent providence do not change. The supposed economy of wants and satisfactions does not change. As an object of analysis it is essentially pre-Darwinian, precisely as the traditional conception of species was. The adaptation of economic theory to evolutionary science is not to be achieved by adding a few chapters on dynamic factors to the theory of static equilibrium. The whole theory posits a conception of economic order which is essentially pre-Darwinian. In major part this derives from a preconceived idea of human nature and as such it is subject to the same influences which have brought about a revolution in psychology and in all other sciences which are concerned with the behavior of the human animal.

INSTITUTIONAL ECONOMICS

By JOHN R. COMMONS
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I am attempting in this paper to give only a theory of institutional economics as derived from the decisions of the Supreme Court of the United States. It is a venture in pure economics, distinguished from its practical applications. The latter belong to individual cases. I have endeavored to make practical applications at other times, in drafting legislative bills, or administering state laws, with the idea of bringing them within the Court's institutional meaning of reasonable value. Such practical application must be made by a state legislature, or the Congress, or an executive in enacting or administering a law. Also, a business corporation, a farmers' co-operative, or a labor union must make a practical application in carrying out a policy which the Supreme Court may perhaps not declare unconstitutional. For I think that whatever the Court thinks is reasonable it also decides is constitutional.

Economic science has not, to my knowledge, incorporated within itself a theory of reasonable value. It separates ethics, public welfare, or national public interest as a postscript, different from economic theory. But a theory of reasonable value, which shall include these postscripts, has become obligatory, in America at least, if the practical application of economic science is to be made to fit the Constitution. I shall not here consider these applications except as data from which to derive the theory.

The economic theories of the past hundred and sixty years were started, in the year 1776, with Jeremy Bentham's repudiation of Blackstone. Thereafter economists went off on theories of happiness, but courts and lawyers continued on the theory of the common law of England and America.

A primary difference between the two is that the common law is built on conflicts of interest between plaintiffs and defendants, but with the sovereign, in the person of a judge, deciding, in each case as it arises, what is reasonable between the two, both in their conflicting private interests and in the public interest for which the sovereign is responsible.

But the happiness theory started with an assumed harmony of interests. It could be none other than individualistic and cosmopolitan without any nationalistic public interest. Only an individual can feel pain and pleasure. Bentham consistently treated all individuals as a world census of population and not as national organized societies, wherein the pleasure of one is often the pain of others. Stating it in technical economic terms, Bentham started, as one may derive from what Mitchell names his "felicific calculus,"[1] with the simplified assumption of an individual seeking his own maximum net

[1] Cf. W. C. Mitchell, "Bentham's Felicific Calculus," *Political Science Quarterly*, XXXIII, 161 (1918).

income of happiness by seeking the maximum gross income of pleasure and reducing to a minimum his gross outgo of pain. The spread between the two was the net pleasure of happiness for the individual, but regardless, obviously, of the pains, pleasures, or happiness of other individuals.

This happiness economy was readily converted, as Bentham did, into a money economy. The individual seeks his maximum net income of money by maximizing his gross income of money and reducing to a minimum his gross outgo of money, regardless, by analogy to net pleasure, of the effect on others arising from the fact that his maximum gross sales income is the maximum amount of money that he can obtain from others as buyers, and that his minimum gross outgo of money is the smallest amount of money he is forced to pay to sellers. The spread between the two is a maximum profit or minimum loss economy,[2] regardless of the consequences to others.

Finally, when Bentham's individual becomes the collective owners of a corporation, acting as a unit, the same maximum net money income is sought for the owners as a whole, regardless of the effects on buyers of the maximum prices paid by them for products and services, or the effects on sellers of the minimum prices paid to them for materials and labor.

Since corporations are falsely treated as individuals, I name these theories maximum net-income economics instead of individualistic economics. This is a technical phrasing of the net-income maxim, "buy in the cheapest market and sell in the dearest market"; to which, in its simplified assumption, should be added, "without consideration of methods or effects on others."

I am speaking of the working hypothesis of pure self-interest, from Bentham to marginal utility. It is a maximum net-income economics. In recent years the theory has incorporated certain institutional factors, like patents, trade names, trade marks, goodwill, under such names as "imperfect competition," "monopolistic competion," "competitive monopoly."[3] Yet

[2] I know that this assumption of disregard of others, in obtaining the maximum net income, will be denied by economists as involved in their theories, and that they place a natural limit on net incomes by the law of supply and demand. Yet I think they quite properly follow Adam Smith who wrote, "I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it." Smith and followers rested their case on the public interest in increase of wealth to be derived from individual initiative. But economic history shows that at times too much wealth is produced by individual initiative and at other times too little wealth is produced. This is because the law of supply and demand has a double meaning, the traditional meaning of producing and consuming material products and the institutional meaning of selling and buying rights of ownership. There are thus two laws of supply and demand—the consumers' law and the business law. The business men buy in order to sell and they buy and sell over and over again far more often or far less often the given rights of ownership than there are products produced and delivered. But the consumer buys only once, and he buys once only as much as he wants to consume. It is a difference both in kind and in velocity. The first is a speculative law of supply and demand. It rests on the legal tradition that his profits are his own—why can he not do what he wants to do with his profits regardless of the effects on others of cycles of overspeculation and underspeculation. The second is a producers' and consumers' law of supply and demand suited to precapitalistic or home economics.

[3] Cf. Edw. Chamberlin, *The Theory of Monopolistic Competition* (1933); Joan Robinson, *The Economics of Imperfect Competition* (1933); and references there cited.

even with these added evolutionary complexities the theory continues to be a maximum net-income economics, regardless of others. Its characteristic problem is that of the optimum size of an individual establishment for obtaining the maximum net income of money.

But these new factors thus introduced bring to the front two additional points of view; namely, the effect on other persons and the public purpose involved. These two aspects are combined by the Court in the meaning of reasonable value.

While a patent right may augment the net income of its owner by means of the monopolistic privilege which it affords, yet for three hundred years in England and America this augmentation has been justified, for a limited period of time, as differing from other sovereign monopolies in that it is granted only for new inventions or discoveries, and thereby fulfills the public purpose of inducing individuals to augment the national wealth while endeavoring to augment their private net incomes.

And while the goodwill of a competitive business is perhaps its most valuable modern asset towards augmenting its net income, in that it lifts its owner above the level of the free competition of traditional economics, yet it differs from other monopolies in that it exists only as long as its owner fulfills the public purpose of rendering to others what they willingly agree are reasonable services at reasonable prices. The Supreme Court has definitely decided that a monopolistic corporation, like a gas company, shall not be permitted to set up a goodwill value as a justification for charging its monopolistic prices.[4] The goodwill of a business or profession is indeed the most perfect competition known to the law. It is founded, however, on the three economic conditions, not of pleasure, pain, or maximum net income, but of equal opportunity, equality of bargaining power, and public purpose. Thus understood, goodwill is the high point of fair competition and reasonable value in the public interest, contrasted with the economics of free competition and maximum net income for private interests, regardless of others and regardless of public interest.

Goodwill is, further, the meeting point of pure institutional economics and pure net-income economics. It has two sides. On the net-income side it augments the private net income beyond that of competitors. On the institutional side it is the reasonable ethical relation towards other buyers and sellers, who are also members of the same national economy.

When the courts reduce their standard of goodwill and reasonable value to its simplest assumption, which they derive from the common law, it rests on the maxim of a willing buyer and a willing seller. In technical

[4] *Wilcox* v. *Cons. Gas Co.*, 212 U.S. 19, 42 (1909). See also lower Courts 81 Fed. 20 (1897) and 157 Fed. 849 (1907). Comment by Commons, *Legal Foundations of Capitalism*, p. 191 (1924). It must be noted, of course, that economic goodwill is not a sentiment of affection; it is an objective economic quantity which can be bought and sold, and whose value is reasonable. Goodwill is often used as a camouflage, and even the Supreme Court has confused it with debt. (*Hitchman Coal Co.* v. *Mitchell*, 225 U.S. 229 [1917]; Commons, *Institutional Economics*, p. 668 [1934].)

language this rests on the fact that the gross income of money acquired by a seller is the identical gross outgo of money given up by a buyer in a single transaction, since it is merely a transfer of ownership; whereas, in net-income economics, the net income is the spread between maximum gross income of money and minimum gross outgo of money of one party who is a buyer in one transaction and a seller in another transaction. There can arise no question of reasonableness in maximum-net-income economics. It is only a question of economic power.[5] But the institutional economics of willingness takes into account the ethical use of economic power in a single transaction where the gross income acquired by one is a transfer of ownership of the identical gross outgo alienated by another. While the one may be named the maximum net-income economics of one person in two transactions the other is the gross-income-outgo economics of two persons in one transaction.

If I trace the beginning of maximum net-income economics to Jeremy Bentham in 1776, I find the beginning of goodwill economics in the year 1620, when the judges of the highest courts of England distinguished a free trade from a restraint of trade between a buyer and a seller.[6] The goodwill concept is literally the willing-buyer-willing-seller concept. It was arrived at both negatively and positively. Negatively, a free trade was an agreement between a seller and a buyer, neither of whom, from the standpoint of public welfare, was restrained by the other or by the state. By removing all economic coercion, all duress of violence, and all psychological misrepresentation from either party to a transaction, through the decisions of the common-law courts, and leaving only honest persuasion, the resulting transaction between the two was free, equal, and willing in the reciprocity of alienating and acquiring the two ownerships. These were the ownership of money on the one side and the ownership of materials or services as valued by that money on the other side. But the positive assertion of what was thus negatively arrived at was that of a willing buyer and a willing seller. This formula has thus become for three centuries the simplified economic assumption of the English and American common law.[7]

[5] Maximum net income, in modern economics, is maximum net profits. Statistically it is found in the income tax reports of the Internal Revenue Department. On margin for profits, that is, net income of profits, see Commons, *Institutional Economics*, pp. 526ff. (1934).

[6] *Jolyffe* v. *Brode*, Cro. Jac. 596 (1620). Also reported in Nov 98, 2 Rolle 201, W. Jones 13. Commons, *Legal Foundations of Capitalism*, p. 263. This case was one where the seller of a carpenter shop agreed to refrain from competition with the buyer. The decision sanctioned what afterwards became known as a going-concern value, considerably in excess of the value of the physical plant. On the merger of common law and equity, see H. Lévy-Ullman, *The English Legal Tradition* (tr. 1935).

[7] The formula of gross-income-gross-outgo applies to both selling and buying transactions. In a selling transaction the gross money income of the seller of his product or services is the identical gross money outgo of the buyer, because he merely transfers the ownership of the identical money to the seller. Reciprocally, in the same transaction, the money value of the seller's output of products or services, whose ownership is transferred

Hence the only standard that can be used by the courts in eliminating these unfair practices and restraints from the double transfer of ownership is the standard of a willing buyer and a willing seller, who, by the very terms thus used, are free from all of these inequalities and injustices. The nearest approach, where the standard is almost perfectly reached, is in the economic quantity known as the goodwill of a going business. Goodwill is the realized institutional economics of the willing buyer and seller.

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by the seller, is the identical money value, at the time, of the gross income of products or services whose ownership is acquired by the buyer.

But the seller has also, in a preceding transaction, been a buyer of the materials and labor, which he then converts into his own products or services which he afterwards sells. Hence the same formula of gross-outgo-gross-income applies, but inversely, to his previous buying transaction.

This meticulous twofold formula would usually be taken as an elaboration of the obvious and a superficial and commonplace notion of money as both a medium of exchange and a measure of value. But there are certain observations in institutional economics that follow from this obvious fact.

The so-called "exchange" of money, materials or services is not an exchange of physical products or material services, as assumed by the classical and hedonistic economists. It is two transfers of two ownerships. The physical delivery occurs after the ownership is transferred. Hence the term "transaction" is appropriate instead of "exchange." A transaction means the negotiations culminating in two transfers of ownership. But ownership and its alienation are created solely by the institution of sovereignty.

Likewise, the money used as a medium of exchange and measure of value is solely a legal tender creation by sovereignty. This has been expounded recently in the gold clause decisions. If credit is used instead of money, it also is the legal creation of debt. The price, or money value, therefore, paid by a buyer, is not, as assumed by traditional economics, a price paid for materials, or services, or labor, but is a price paid for ownership of the materials, services, or labor. The price is a valid price only because the state protects the new owner as it did the former owner. The legal test of validity is the Court's determination of willingness of each at the time of the transaction.

Again the precise time of transfer of ownership is of importance in the measurement of value. This is because two debts are created by the transaction at a point of time—a debt of payment and a debt of performance. These debts are equivalent to the value willingly agreed upon in the transaction. The debt of payment is released by a payment of legal money. The debt of performance is released by physical delivery of the materials, services, or labor, as measured by other legal units. It was this physical delivery of materials that became the subject matter of the traditional exchange-value. But it is ownership delivery that is the subject matter of institutional economics. The two were identified on account of the double meaning of a commodity, which is a physical thing which is owned.

After the date of the transaction when the two ownerships of money and commodities have been transferred by operation of law, there may be greater or less changes of values in the hands of new owners, commuted mainly as risk and interest. But at the precise date of the transaction the value of the gross outgo or gross income of materials, services, or labor are, by agreement, by contract or by debt, identical with the amount of money paid or received.

This is true, no matter how high or low, how oppressive or onerous, how coercive or intimidating, how fair or discriminatory, is the monetary price, nor how large or small is the quantity of money, materials, services, or labor power, whose ownership is alienated by one and acquired by the other.

For these reasons I do not think that institutional economics, defined as collective action in control of individual action, is contrary to the so-called pure economics of the past, which is individual action without collective control. It is a continuation of pure economics into a higher degree of complexity by incorporating the reasonable value of willingness into the already expanding maximum net-income economics of exchange value. Reasonable value is an upper and lower limit of exchange value placed there by the American Supreme Court. Net income economics, indeed, places upper and lower limits of net income by the so-called law of supply and demand. But institutional economics places another upper and lower limit by the law of reasonable value.

Yet the highly valuable goodwill of a business has not, until recently, found a place in the traditional net-income economics. I take it the reason is that pure economics has been based on man's relation to nature instead of man's relation to man. This physical relation furnished a materialistic foundation for labor costs of production and for diminishing utility of consumers' physical goods. But goodwill is purely an institutional value, that is, so-called "intangible value," of man's equitable relations with other men. Its value may far exceed the cost of production or may fall far below the cost of production of physical things. And its value has no immediate relation to the satisfaction of wants. Its value is derived solely from the willingness of owners, without coercion, duress, or misrepresentation, to alienate to each other their rights of ownership. This is the simplified hypothesis of institutional economics.

Yet I do not overlook the important contributions to economic theory in the past, whether orthodox or heterodox. I correlate them with institutional economics. The classical and communistic economists used as their measure of value the man-hour of labor. This is evidently, since the incoming of scientific management, the engineering economics of efficiency. The Austrian and hedonistic economists, deriving from Bentham, used as the measure of value the diminishing marginal utility of consumption goods. This is evidently the home economics recently introduced in the college curriculum.

But institutional economics is the field of the public interest in private ownership, which shows itself behavioristically in buying and selling, borrowing and lending, hiring and firing, leasing and renting. The private interests become the field of intangible yet quantitative and measurable rights, duties, liberties, and exposures to the liberties of others. These are various aspects of rights of ownership. What we buy and sell is not material things and services but ownership of materials and services. The correlation of engineering economics, home economics, and institutional economics makes up the whole of the science of political economics.

The only net-income economist, as far as I know, who took the trouble to examine these institutional factors and then consciously to exclude them from his pure economics of man's relation to physical nature, was Böhm-Bawerk, in 1883. Others excluded them by taking them for granted without investigation. He excluded them explicitly under the names of "rights" and "relations."[8] On examination of what he meant by these terms I find that he meant all kinds of ownership, and he limited his pure economics to the physical and psychological process of producing and consuming material things. But if his pure economic man should go along the street picking up groceries, clothing, and shoes according to their marginal utility to him, he would go to jail. He must first negotiate with an owner to whom

[8] Eugen v. Böhm-Bawerk, *Rechte und Verhältnisse* (1883).

the policemen, courts, and constitution have given the right to withhold from him what he wants but does not own, until that owner willingly consents to sell his ownership. This is his exposure to the liberty of owners, and this keeping out of jail is a part of what I mean by institutional economics.

The legal right to withhold is therefore the ultimate basis of all the imperfect or monopolistic competition that has begun to creep into the pure net-income economics of marginal utility. It may be named institutional scarcity superimposed upon the psychological scarcity of diminishing utility.

This simplified assumption of willing buyer and seller might well be taken as the starting point of all economic theory, instead of starting with self-interest. It is the ethics of economics. For goodwill is not only customers' goodwill, it is bankers' and investors' goodwill; it is the goodwill of laborers and sellers of materials, the goodwill of landlords and tenants, even the goodwill between competitors, in so far as may be deemed by the Court not inconsistent with the public interest. In short, these varieties of goodwill, from the side of net income, are the valuable expectations that other economic classes will willingly, and therefore without duress, coercion, or misrepresentation, repeat in the future their mutually beneficial transactions.

The right to withhold is also the economic foundation of reasonable value. It came up, in its modern variety of economic coercion, with the growth of large-scale industry and the mass bargaining power of thousands of stockholders acting collectively as one person under the legality of corporation finance. This collective action is not, in fact, monopoly in the historic meaning of monopoly; it is merely the historic meaning of private property itself, but operating on the grand collective scale of associated property owners withholding from others what they want until they agree to pay or work for it. When industry reached the stage of public utility legislation, as it did fifty years ago, an essential part of this legislation was that of depriving owners of a portion of their right to withhold services by commanding them to render service on the terms specified by the Supreme Court as reasonable for both sides of the bargain.

In other cases where monopoly was not recognized, and therefore the Supreme Court did not permit compulsory service or price fixing, the principle of a willing buyer and willing seller led to the law of fair competition as against the free competition of traditional economics. Economic goodwill is the law of fair competition.

But it was in the case of so-called public utility corporations that the modern version of reasonable value began to creep into exchange value. The basic principle of a willing buyer and seller was being violated by the emergence of large-scale corporations. The legislatures, under the limitations deemed reasonable by the Supreme Court, endeavored to set upper limits

of price and lower limits of service within a range that the Court might deem not incompatible with the ideal of a willing buyer and a willing seller.

This principle might be named the ideal of the common law, just as maximizing net income is the ideal of individualistic economics. In either case, one or the other is the most simplified assumption of its own pure economics, and might therefore be named the first principle of the science. But in the practical application of the science to specific cases these simplified assumptions are necessarily modified by consideration of what is practicable or impracticable under all the complex circumstances of that case at that time. In such a particular case the goal, or first principle, sought to be reached by the practical man, whether of maximum net income by the individualist or of willing seller and buyer by the Court, becomes the practicable or realistic application of the abstract science to the great complexity of favorable and unfavorable circumstances in that specific case. This, in the decisions of a Court, is the meaning of reasonable value. It is reasonable because it is the nearest practicable approach which the Court, in a specified dispute up for decision, thinks it can make towards the idealistic assumption of a willing buyer and willing seller.

Reasonable value, as I define it in following the Supreme Court, is not any individual's opinion of what is reasonable. This is the usual objection raised against a theory of reasonable value. There are as many individual opinions of reasonableness as there are individuals, just as there are as many opinions of what is pleasurable or painful as there are individuals. Reasonable value is the Court's decision of what is reasonable as between plaintiff and defendant. It is objective, measurable in money, and compulsory.

Neither is the individual permitted to say that he was unwilling. In case of dispute, the Court alone, if only to prevent anarchy, says whether he was willing or not. He must adjust his will, if he can, to the Court's will.[9]

So, also, individual opinions regarding the Court's decision itself of reasonable value, and even majority and minority opinions within the Court, have as many differences as there are individuals. But the Court's decision must be obeyed, by the use of physical force, if necessary.

Hence it is not opinions or theories that must be obeyed; it is decisions, which take the form of compulsory orders, that must be obeyed. Individual members of the Court may write out their own different opinions. But these are justifications or criminations. They are feelings, not acts. They are even

[9] The Court, in laying down the rule for ascertaining reasonable value in a particular case, states, in effect, that all conflicting theories of value must be given consideration and that to each theory must be given its "due weight"; that is, a reasonable value of the theory itself in its relation to all other theories of value, according to the facts and public purposes in that case. (*Smythe* v. *Ames*, 169 U.S. 466, 1898.) This is because these conflicting theories of value are really partisan theories set up by conflicting economic interests, each interest seeking for itself the maximum net income at the expense of other interests and of the public interest as a whole.

not necessary except as concessions to outside opinion. It is the decision that counts, and the decision is a fiat of sovereignty. The fiat is arrived at, in this country, by a constitutional process of majority rule within the Court. Under other constitutions it may be arrived at by a dictator exercising the judicial function by appointing and removing the judges at will. It need not then be justified and cannot be criminated without free speech. In such cases it is arbitrary fiat, not reasonable fiat.

But reasonable value, in the United States, is what the constituted Court decides is reasonable, by mere fiat, not what individuals think is reasonable. There have been decisions of the Court which I personally think were unreasonable, even dictatorial and capricious.[10] Such decisions I attribute to upbringing of members of the Court in the maximum net-income economics of corporation finance. But nevertheless I and the American people must obey the decision while it lasts.[11] It is not a matter of subjective or individual opinion; it is the constitutional structure of the American judicial system that decides.

This is because the United States differs from other nations in that its sovereignty is split in two directions: the legislative, executive, and judicial

[10] Cf. Robert L. Hale, "What Is a Confiscatory Rate?", *Colonial Law Review*, xxxv, 1046, 1052 (1935); Edw. S. Corwin, *The Twilight of the Supreme Court* (1934).

[11] There is an evolutionary principle within the Anglo-American common-law idea of willingness corresponding to the evolution of sovereignty from the time of William the Conqueror. The idea started in warlike and feudal times when only the wills of martial heroes were deemed worth while; then was extended to unwarlike merchants in the law of the market overt; then to serfs and peasants; then to the most timid of people, for whom not only actual violence or trial by battle, but even the merest subjective apprehensions of inferiority created fear which deprived them of their freedom of will. (*Galusha* v. *Sherman*, 105 Wis. 263, 1900.) Then towards the end of the nineteenth century this simplified formula of a free will was extended to the relations between employers and employees, on the economic assumption that employers, being owners of property, were in a stronger economic position than propertyless laborers, such that laborers were deprived by fear of unemployment of their freedom of will in bargaining. (*Holden* v. *Hardy*, 169 U.S. 366, 1898.) Further variations were partly allowed where women and children were deemed economically unequal to the superior managers, merchants, lawyers, or employers; so that the agreements which they made respecting the price of labor were not contracts between willing buyers and willing sellers. Many other complexities arise with the incoming of large-scale production, collective action, and the cycles of prosperity and depression; and these also are among the variabilities that must be taken into account in the evolutionary application of the basic principle of the willing buyer and willing seller.

A recent writer (O. Lange, in *The Review of Economic Studies*, June, 1935) holds that economic theory does not have within itself a principle of evolution, and must follow Karl Marx in a theory of historical materialism in order to derive a theory of economic evolution. But I reduce Marx to a theory of efficiency measured by man hours as an essential part of economic theory, although usually measured by dollars. And I find economic evolution in the changes in custom, the changes in citizenship, the changes in sovereignty, as well as in technological changes. Lange includes, in his meaning of technique, changes in "organization," which, with me are changes in institutions. The evolutionary principle in the common law comes under Darwin's artificial selection, not his natural selection. It is artificial selection by judges.

This evolutionary principle is possible because lawful economics is itself highly variable though founded, in Anglo-American common law, on the willing-buyer-seller assumption. Not only does it have the variabilities of corporeal, incorporeal, and intangible property, and the variabilities of reasonable and unreasonable values, but also the revolutionary variabilities of communism, fascism, nazism and the gold clause decisions.

branches, in the one direction, and the federal and state branches, in the other direction. Yet since the year 1890[12] the Supreme Court has held that, while in many matters the states are sovereign, yet in the one matter of economic valuations and activities the Supreme Court of the United States is sovereign over both the states and the executive and legislative branches of the federal government. In railway valuations, for example, the Court has deprived the states of their sovereignty. But even where the Court asserts state sovereignty, as in the NIRA decision, the economic acts of state sovereignty are subordinated to national sovereignty under the dominion of the Supreme Court of the United States. Any federal or state official may be brought before the Supreme Court as defendant, on petition of a private citizen or corporation as plaintiff, in a dispute over economic valuations or economic transactions. Consequently executive and legislative sovereignty, whether federal or state, in the field of economics, are subject to the national judicial sovereignty. The Court thereby becomes, in economics, a superior branch of both the federal and the state legislatures, differing mainly in its procedure.

This should be named a nationalistic theory of economics, instead of individualistic, cosmopolitan, or communistic. It parallels the trend toward nationalism the world over during the past fifty years, especially since the World War. This nationalistic theory of value, under the sovereignty in America of the Supreme Court, I describe as an institutional theory of economics. In order to correlate it with the maximum net-income economics of the past one hundred and sixty years, I name an institution collective action in control of individual action. It may be unorganized collective action, which is the meaning of custom, or organized collective action like that of a corporation, a co-operative, a trade union, or the state itself. If organized, it necessarily acts through executive, legislative, and judicial organs, whether combined or separated. There are other meanings of institutions, as I know, but I find that this meaning of collective action fits the facts of my experience.

The supreme organized collective action is the monopoly of physical force by taking violence out of private hands. This is sovereignty. There are subordinate forms of organized collective action, sanctioned by the physical force of sovereignty but authorized, in the case of business corporations, to use the economic sanctions of scarcity, or, in the case of churches or clubs, to use the merely moral sanctions of collective opinion. These subordinate forms are delegated forms, since they are created, permitted, regulated, dissolved, or prohibited by the supreme institution, sovereignty.

I date the modern recognition by the state of these delegated forms of economic collective action from the time of the general corporation laws beginning in the decade of the 1850's, and I consider this period to be

[12] *C. M. & St. P. Ry. Co.* v. *Minnesota,* 134 U.S. 418 (1890).

the beginning of modern capitalism. These corporation laws endowed individuals with a new universal right, the right of collective action, previously outlawed as conspiracy, and not previously granted as universal but granted only as a monopolistic special privilege by a special act of the legislature. This new universal right of collective action was evidently called for by the incoming of modern widespread markets and corporation financing. Today, it is estimated, nearly 90 per cent of manufactured products in this country are produced by corporations.[13] In agriculture there is authorized by the state an amazing extension of co-operative associations controlling more or less certain economic activities of individual farmers. The extent of judicial authorization of trade unions in their control of individuals is well known. Even the individual banking business is more or less controlled by the collectve action of the member banks of the Federal Reserve system, subject to the Supreme Court.

With the incoming of these collective controls the older individualistic economics becomes obsolete or, rather, subordinated to institutional economics. The freetrade individual of Adam Smith and Jeremy Bentham disappears in exactly what they denounced; namely, protective tariffs, state subsidies, corporations, unions, co-operatives—all in restraint of individual free trade.[14]

[13] By the National Industrial Conference Board, report on *Federal Corporation Income Tax*, Vol. I, pp. 23, 126 (1928).

[14] A fiction is introduced by personifying corporations as individuals and giving to them not only the economic rights, liberties, and responsibilities previously attributed to individuals, but also the additional sovereign rights and liberties of collective action, limited liability, and so-called immortality. They are not individuals—they are organized collective action in control of individuals. This personification of collective action ends in the inequality of treating as equals a concerted thousand or hundred thousand stockholders and bankers, acting together as a single person, in dealings with wage earners or farmers or other buyers or sellers, who act separately in their naked individualism of Smith, Bentham, Ricardo, the Austrian economists, the Declaration of Independence.

The statement of this fiction is found in the case of *Santa Clara County* v. *So. Pac. R.R. Co.*, 118 U.S. 394, 396 (1886). The Court said, "One of the points made and discussed at length in the brief of counsel for defendants in error was: Corporations are persons within the meaning of the 14th Amendment." Chief Justice Waite said: "The Court does not wish to hear argument on the question whether the provision in the 14th Amendment forbidding a State to deny to any person . . . equal protection of the laws applies to corporations. We are all of opinion that it does." See E. S. Corbin, *Twilight of the Supreme Court*, 205 (1934). When the state of Wisconsin started, in 1907, to regulate public utilities it required all of them to take out corporate charters. Many individuals and partnerships convert themselves into corporations for other than technological reasons.

All economic theories distinguish between activity and the objects created by that activity. A familiar instance is "production" and "product." So with institutional economics. The distinction can be fixed by the terms "institution" and "institute." The institution is collective action in control of individual action. The institutes are the products of that control. What are usually named institutions are more accurately named institutes. The institutes are the rights, duties, liberties, even the exposures to the liberty of others, as well as the long economic list of credits, debts, property, goodwill, legal tender, corporations, and so on. Even the individual of economic theory is not the natural individual of biology and psychology; he is that artificial bundle of institutes known as a legal person, or citizen. He is made such by sovereignty which grants to him the rights and liberties to buy and sell, borrow and lend, hire and hire out, work and not work, on his own free will.

If we reduce organized collective action to its simplest possible formula, we have three parties to the transaction; namely, a plaintiff, a defendant, and a judge. This is indeed the simplest formula of sovereignty itself.[15] A similar formula applies to all subordinate organizations. The three parties are clearly separated in commercial arbitration, labor arbitration, and by means of the discipline committee of a stock exchange or a produce exchange. But the judicial function is more or less merged with the executive and legislative functions in a corporation or a dictatorship.

This judicial sovereignty over economic affairs in the United States derives from the "due process" clause of the federal Constitution. No person shall be deprived of life, liberty, or property by either an executive or a legislature or a lower court or a state or federal government without due process of law, as determined by the Supreme Court. The meaning of due process, however, has been changed by the Court within the past fifty years. Originally the term, as stated by Corwin,[16] "meant simply the modes of procedure which were due at the common law. . . . Today," continues Corwin, "due process means reasonable law and reasonable procedure, that is to say, what the Supreme Court finds to be reasonable in some or other sense of that extremely elastic term."

It is from this later meaning of due process of law that the economic term "reasonable value" finds its place in American economics. Reasonable value is welfare economics as conceived by the Supreme Court.

For these reasons there is in American economics a written Constitution and an unwritten constitution. The written Constitution was written in 1787 and in succeeding amendments. The unwritten constitution was written piecemeal by the Supreme Court in deciding conflicts of interest between plaintiffs and defendants. We live under this unwritten constitution; we do not even know what the written Constitution means until the Supreme Court

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Merely as an individual of classical and hedonistic theory he is a factor of production and consumption like a cow or slave. Economic theory should make him a citizen, or member of the institution under whose rules he acts.

This distinction between institutions and institutes will, perhaps, account for a criticism of my *Institutional Economics*, by P. F. Brissenden in *The Nation*, June 26, 1935. Brissenden says that the book "is full of theories of value, transactions, and 'going concerns' but almost empty of institutions." The explanation, I take it, is that he overlooks my definition of institution as "collective action in control of individual action" which I had named a going concern. But the values, transactions, rights, duties, debts, corporation assets, and liabilities, working rules, and so on, expressed quantitatively by measurement in terms of legal tender, are what I should have distinguished as the various institutes created and enforced by the institutions. Justinian's institutes were drawn up by lawyers selected by him, but it was Justinian himself, at the head of the institution of sovereignty, who proclaimed and enforced them. Economists who reject institutional economics have always been using institutes. It will be seen also that I do not use the word institution as interchangeable with sociology. I mean legal and legalized institutions.

[15] Cf. Hans Kelsen, *Allgemeine Staatslehre* (1925).

[16] Edw. S. Corwin, *The Constitution and What It Means To-Day*, 105 (4th ed., 1930); Commons, *Legal Foundations of Capitalism*, pp. 333ff. (1924); see especially majority and minority opinions in *Hurtado* v. *California*, 110 U.S. 516 (1884).

decides a case. When we investigate reasonable value we are investigating the unwritten constitution. When we investigate the evolution of reasonable value we are investigating the Court's changes in meanings of such fundamental economic terms as property, liberty, person, money, due process. Each change in meaning is a judicial amendment to the Constitution.[17]

Thus, while the early economists, from Thomas Aquinas to John Locke, Adam Smith and David Ricardo, culminating awkwardly in Karl Marx, eliminated money and prices but made labor cost the measure of value, the institutional economics of the common law and the Supreme Court makes legal tender money and the free will of buyers and sellers the measure and standard of reasonable value.

[17] This is the predicament in teaching the Constitution to children in the public schools and in meeting the repeated demand that we "go back to the Constitution." We cannot go back to the written Constitution. We go back to the unwritten constitution. In the case of the institutional economics of reasonable value we go back to the common-law assumption, and its later evolution, of a willing buyer and a willing seller. This is the simplified economic assumption of the unwritten constitution. There are other sources of the unwritten constitution, but I am speaking here of economic valuations by public authorities which the Supreme Court has said are a judicial question. See W. B. Munro, *The Makers of the Unwritten Constitution* (1930); C. E. Merriam, *The Written Constitution and the Unwritten Attitude* (1931); R. L. Mott, *Due Process of Law* (1926); E. S. Corwin, *The Constitution and What It Means To-Day* (4th ed., 1930).

The gold clause decisions were a revolutionary change in the unwritten constitution as previously decided in the legal tender cases. They changed the meanings of "obligation of contracts" and of value, by transferring from creditors to debtors millions of dollars which had been willingly agreed upon at the time when the debts were contracted. But similar judicial revolutions have occurred in the meanings of other words in the unwritten constitution. See Commons, *Legal Foundations of Capitalism* and *Institutional Economics* on the Court's changes in the constitutional meanings of property, liberty, person, and due process of law.

It is upon the ground of the primary assumption of willing buyer and willing seller in the unwritten constitution that I argue for a mandate of Congress for a reasonable stabilization of prices as far as practicable by the Federal Reserve system. The gold clause decisions are an evolution from the legal tender cases. They leave no fixed weight of gold as the measure of value. They assert the validity of legal tender paper throughout the nation as fulfilling the constitutional obligations of contract. The stabilization of legal tender prices is the stabilization of creditor-debtor relations. If such a law were enacted by Congress its constitutionality, as construed by the Court, would be a further evolution of the unwritten constitution.

This bears on the debated point of judge-made law. The judges do not actually make law. They decide particular disputes. Then it is expected that they will decide similar disputes in a similar way, and so, what is the use of bringing up the same point again? This is not so much the way in which law is made as it is the way in which custom is made. A description of the evolution of custom, in Anglo-American law, is the change in habits due to change in expectations of what the courts will do in deciding conflicts of interest. This is more appropriately named judge-made custom instead of judge-made law. In America, this evolution of judge-made custom in economic affairs is the growth of the unwritten economic constitution.

DISCUSSION

WILLARD E. ATKINS: I shall not attempt to criticize the conclusions of Professor Commons that the institutional economics of the common law and the Supreme Court make legal tender money and the free will of buyers and sellers the measure and standard of reasonable value. On the other hand, any institutionalist must recognize, and probably Professor Commons does recognize, that the Supreme Court in no sense is an absolute sovereign. In practice the Supreme Court can declare itself against a monopoly, as the common law did before there was such a thing as a Supreme Court or a Sherman Anti-Trust law, but the economic phenomena of monopoly do not cease to function. The Supreme Court may lay down a decision with respect to what constitutes a reasonable basis for public utility valuation, but the particular price which is paid for electricity may be a function, not so much of a Supreme Court decision as the technology of the industry, but rather the rapacity of holding companies with their juggled accounts, the absence of ability within the judicial system to appraise the issues involved, the cleverness of lawyers, the law's delay, the struggle of a politician for power—yes, even the perjury of witnesses and the bribery of legislators. In a given case these latter factors may be much more descriptive of a given utility price than a decision by the Supreme Court of the United States on the question of what is a reasonable return.

In other words, the Supreme Court must be given meaning, not as an institution set off by itself, but rather as part and parcel of the contemporary scene. It is to be understood and it possesses meaning when viewed in relationship to the habits, practices, and attitudes of mind in the environment of which it is part. Studies by Walton H. Hamilton in recent years have brought forth valuable evidence in support of this point of view. Particularly, I refer to such articles as "Caveat Emptor," by Walton Hamilton, in the *Encyclopaedia of Social Sciences* (Volume 3, pages 280-2). Such studies indicate that the law itself is in the grip of changing business practices.

An institutional approach requires a study into the social order that produces the judges, the lawyers, and the judicial practices which exist and the practices and beliefs of a business economy which explain the decisions which are made. If we are to impute any value to the efforts of such men as Professor Hamilton and others such as Professors Pound and Frankfurter at Harvard, it is because they suggest that the Supreme Court is a form of social expression to be understood in terms of the technology and processes of society of which it is part. Institutional economics, therefore, demands primarily an examination of the practices, the attitudes of mind, and the conduct of individuals in the market place, which, in turn react to change and reshape the decisions of the Supreme Court. The studies of Professor Commons will be useful if the decisions of the Supreme Court are viewed as simply a part, and perhaps a small part, of the total play of the technology and the thought patterns of industrial society.

With the ideas presented by Dr. Clarence Ayres I find myself in agreement. Unfortunately, much of our economics is still pre-Darwinian. Much of it is pure rationalization. But if we view the past fifty years, we cannot say that it has been wholly without change. Consider the description of the earlier part of the

fifty-year period given by Charles A. Beard and Mary R. Beard in *The Rise of American Civilization* (Volume 2, page 429):

> The capitalist system . . . like every other social organism, had to evolve a scheme of defense and, as things turned out, the task of justifying to man his own handiwork fell mainly to the economists in the universities that sprang up like mushrooms as the gilded age advanced. At Yale, William G. Sumner vindicated in lecture and treatise the economics of Manchester so acceptable to captains of industry eager to be left alone—at least in domestic affairs if not in the matter of tariffs. At Columbia, John Bates Clark, in his *Philosophy of Wealth* and later in his *Distribution of Wealth,* showed with a lavish display of learning and logic that on the whole the capitalist system worked for justice, rough-hewn, but still justice; to put his system in more severe terminology, each factor of industry, particularly capital and labor, is rewarded in the main according to its contribution and thus business enterprise partakes of even-handed equity. Under the terms of a gift from a wealthy manufacturer, the Wharton School established in 1881 at the University of Pennsylvania was expected to expound the protective tariff as a highly praiseworthy economic device.

While today perhaps there are many economists still holding the traditions of the economics of the Manchester school, there are others who have seen cracks in the rigid armor of that logic.

Shortly after the creation of the American Economic Association specific studies were started in the fields of labor, taxation, railways, trusts, combinations, and government finance that cut away from the moral inference that on the whole all things worked out for the good if left alone. This good work has gone along. Among the more recent contributions of significance are the work of J. M. Clark in the *Economics of Overhead Cost*; Wesley C. Mitchell, *The Business Cycle*; Hamilton and Wright, *The Case of Bituminous Coal*; Berle and Means, *The Modern Corporation and Private Property.*

Most outstanding in that period is the work of Thorstein Veblen. I refer here not only to his withering analysis contained in his study called *The Economics of J. B. Clark,* which has been described by Beard as "the most consummate piece of academic irony ever produced on this continent," but also to his pioneer work, *The Theory of the Leisure Class,* and particularly, *The Theory of Business Enterprise.* Here was a man and a mind that could appreciate the meaning of rationalization and the imprisoning influences of assuming morality in economic analysis. Here was a mind that appreciated the significance of Darwin and who felt a kinship of economics to modern philosophy, politics, psychology, and anthropology.

Moreover, although our textbooks possess the usual rotundity and commonly incorporate the statics which Dr. Ayers has classified as pre-Darwinian, they by no means are in complete agreement. Gone is the sweet and complete assurance of an Adam Smith and a Ricardo, and when the contents of these outwardly similar texts are examined, we find evidence of struggle, strain, and disagreement.

Part of the unrest has been indicated by the drift of teachers into the business fields and into the schools of commerce. From these outside positions they have thrown back at the traditional economists the charge that their teachings are unreal. Moreover, within the liberal arts college a teacher of labor and of money and banking in his specialized and advanced courses has placed little emphasis upon the utility of most existing economic theory. Books on labor still reproduce a chapter or two on wage theory, but they state them more or

less indiscriminately, and the marginal productivity theory of wages, the fetish of the classical economists, although not viewed with contempt, is passed over quietly and consigned to future generations as a historical instance of the speculations of cloistered economists.

All of these tendencies are a sign of health and a pleasant augury for the future.

EDWARD S. ROBINSON: To begin with I should like to express my agreement with one of the early points made by Mr. Ayres. He stated that economics has been little influenced by the special theories of psychology or by special sets of psychological facts. Since the mid-nineteenth century there have been many pious wishes for the co-operative development of economics and psychology, but thus far specific transferences have been few. As Mr. Ayres goes on to say, this is not due to any fundamental lack of relationship between economic and psychological thinking, but rather to the fact that those who have had the relationship of these two sciences in mind have focused their attention upon the wrong sorts of relationship. Possibly the transfer from specific psychological conceptions and facts to economics may some day be important. Indeed there is evidence that this type of transference is already becoming more prevalent. However, the most vital relationship between these two fields of endeavor exists through the common intellectual climate which they both share and both help to produce. I may add that a similar conclusion can be reached regarding the relationship between psychology and jurisprudence.

Considering the matter from the standpoint of a psychologist, it seems to me that a profitable approach is one in which the psychologist takes the theories of economists and jurists as themselves data for psychological interpretation. Mr. Ayres has pointed out how each economic theory expresses some purpose of its formulator and his time. In the few minutes at my disposal I should like to suggest some typical purposes which social theories seem to embody.

Perhaps the most familiar psychological generalization of this sort is that a social theory may justify the *status quo*. Today vague slogans borrowed from the classical tradition have become the principal weapons of political conservatives. The stock argument against legislative reforms of business abuses is that such reforms are artificial and that they interfere with the so-called "natural" course of trade.

A social theory may argue for a particular type of social change. The optimistic conception of the natural man was an argumentative support for the extension of suffrage. The pragmatic social theory of Holmes, Brandeis, and the New Dealers argues the right to experiment with novel social devices. A social theory like that developed around the "due process" clause may be used to whittle away governmental power. A similar juristic attention to general welfare might, as Mr. Llewellyn pointed out, lead to the building up of governmental control.

A social theory may express the outlook of some particular group within the great society. Thus the "net income economics," of which Mr. Commons speaks, is a fairly good description of the attitude of small traders from the days of Adam Smith to the present. Courts of law, on the other hand, because of their duty to compose contradictory interests, have, as Mr. Commons says, developed

the conception of a fair and reasonable relation between the buyer and the seller. Then there is that social theory pointed out by Mr. Llewellyn which has expressed the purposes of those professional corporation caretakers who have played such a prominent part in our own society. Or turning to the managers of our great impersonal corporations, we might describe an economic theory which builds skyscrapers and operates luxury trains and ships with the aim of earning a vague something called business prestige.

A social theory may be formulated to turn attention upon some new economic or legal development which conventional scholars have hitherto neglected. As Mr. Ayres indicates, economic insurgents, during our own day, are seeking to force the technological processes into the forefront of discussion and have protested against the tendency of the traditional economists to treat technology as an incident rather than a focal point of the total economic process. In jurisprudence the realists are insisting that social forces and social attitudes, hitherto treated as accidental, be given a central position in juristic theory. To the realist it is as important to understand the devices by means of which the courts depart from the doctrine of *stare decisis,* as it is to understand the doctrine itself. It is as important to stress the fact that most divorces are uncontested as it is to stress the doctrine that divorce is legally impossible when both parties desire it.

A social theory may simply express what we think it good for the public to believe. It may be argued, for example, that net income economics is an indispensable fighting faith for the man who would start a business enterprise and keep it going. A principal objection to realism in jurisprudence is that it encourages an ineffective way of talking before conventionally minded courts. The belief that certain theories may be good for people even though those theories are not true is, of course, especially prevalent in the legal institution where certainty is often said to be the primary virtue.

As Mr. Ayres has pointed out, the theories of economics and psychology, and we might add those of jurisprudence also, have always been influenced by the ideals of self-conscious, academic groups who have been seeking to mark off inviolable territories for their own. Economists who have insisted upon barring analysis beyond the concept of price and psychologists who have similarly insisted upon the irreducibility of the sensations and reflexes illustrate this purpose. A proper academic discipline ought to be neat and exclusive. The economist, the psychologist, and the jurist each wants a language which he alone can understand.

Under this concept of academic neatness and respectability we might also introduce a certain craving for conclusiveness. The professor of a science is rarely content to present a picture of the current state of knowledge. He usually wishes to erect a theory predictive of what everything will be like when all is known about it.

The purposes thus far discussed lie ouside the notice of conventional scientific method and logic. Social theories do, however, occasionally establish a ground for inquiry just as do the theories of natural science. Even the classical economics helped to define certain economic problems, such as those regarding variations in price, and to that degree furnished a basis and encouragement for investigation. The same might be said of Austin's analytical jurisprudence, of associationistic psychology, and of practically every theory which has been important in social

thinking. Yet in the case of practically all theories in psychological and social fields, this naturalistic purpose has been greatly limited by the other purposes which I have enumerated.

Finally, a social theory that lays the basis for honest inquiry may have as its remoter objective the control of psychological and social processes. For those of us who have faith in the extension of the scientific method to the social world, this idea of control must be predominant. When control is sacrificed in order that a theory may better serve as a defense of the *status quo,* as an argument for social change, as a proof of academic respectability, that factor of intellectual cost ought to be pointed out and subjected to attack.

THE PLACE OF MARGINAL ECONOMICS IN A COLLECTIVIST SYSTEM

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Within the compass permissible here, it is possible only to develop in a summary and sketchy fashion the essentially negative proposition that the place of marginal economics in a collectivist economy is not essentially different from its place in an economy of "competitive individualism"—or whatever designation may be used for any actual or hypothetical system contrasting with collectivism. This means—and this is the main point to be made in the present paper—that the problems of collectivism are not problems of economic theory, but political problems, and that the economic theorist, as such, has little or nothing to say about them. This holds true whether we consider the problem to be the scientific one of predicting what the collectivist economy would be like in structure and activities, or whether we look at it practically from the standpoint of the right objectives to be pursued and the right principles to be followed in realizing them.

The exposition will naturally begin with abstract principles with respect to which the propositions stated are rigorously true, and proceed to more concrete aspects of the problem, pointing out some of the broader probable differences of content to which the same principles would apply. It will thus fall naturally into three divisions, since the concrete problems facing a collectivist economy (meaning its government) must be considered under the same two aspects recognized in all economic theory; i.e., a preliminary stage assuming stationary conditions, and a second stage including the phenomena of conditions changing cumulatively, cyclically, or erratically.

I. The Rôle of Abstract Economic Principles

Under the head of general principles, our statements may be positive, though brief. A collectivist society of any type would necessarily confront the same economic problems, in the formal sense, as an individualistic one. Only the given conditions would be different, and for the most part, as we shall emphasize throughout, even these would only become different as the policies and activities of the system after its establishment actually changed them. To begin with, some individual human wants will always have to be satisfied by the use, in accord with some system of technical and scientific knowledge, of some stock of productive resources. The collectivist economy would necessarily economize resources in the use of satisfying wants; and this necessarily means that it would strive, consciously or unconsciously, to allocate its resources among the different want-satisfying uses in accord with the principles of marginalism. For the principles of marginalism are the

logical, mathematical, and hence universal, principles of economy; i.e., of maximizing the return from any resources, used in accord with any technique, to secure any form of return; that is, where there are different alternative modes of using resources, each conforming to the principle of diminishing returns, so that a greater total return is secured by apportioning the resources among the different alternatives than by devoting them exclusively to any one, the theory of marginalism describes correct apportionment. And this fundamental general condition would in no wise be changed by the replacement of individual market competition by collectivism, or by changing the form of economic organization in any way whatever. Moreover, the theoretical and practical validity of the principles would be unaffected by any difference in the degree to which, as compared with individualism, the collectivist economy allowed individuals to be the judges of their own wants and the means of satisfying them, or itself made these choices (through some political agency).

It is undoubtedly true, furthermore, that the collectivist economy, meaning its government (made up of politicians), would, to an unknown degree, cherish other ends, and use resources to other ends, than the satisfaction of individual wants, as more or less freely formulated and expressed by the individuals themselves.[1] But whatever the objectives might be, they would be like individual wants in the formal character which is in point here; they would be subject to a principle of diminishing incremental importance, their realization would be limited by the scarcity of means of realization, and these means or resources would have to be allocated among the different objectives, and different kinds of resources combined or organized in each mode of use. The allocation would have to be based on a conscious or unconscious quantitative comparison, by someone, of the relative importance of the results of different uses of resources, over the whole field of possible use, recognizing that relative unit importance varies inversely with the proportion of resources allocated in any direction. It is mathematically demonstrable, but is really self-evident without demonstration, that under any conditions where economy of resources is a problem, and where allocation is involved, maximum utilization is secured by such an apportionment among alternative modes of use that any small increment of any resource makes the same incremental addition to the total result, in value terms (however estimated) in any mode of use that is made by an equal increment in any other use. This, of course, tells us nothing whatever regarding the resources

[1] It should be kept in mind throughout that in using the terms "individualism" and "individual" we have in mind something like the existing situation in competitive economic society. By an individual, we mean the freely contracting member in full standing of the economic system. The category does not include "dependents," and the terms of contract are determined and restricted by practically the whole body of law and authoritative custom in force at a given time and place. In what we call individualistic society, the family is in many respects a more real, human, economic unit than the biological individual.

actually used in any economy at any time, or the concrete modes of use. Regarding the character or content of economic life, economic theory has absolutely nothing to say.

The collectivist economy will also necessarily confront the same general problems of the relation between present and future as any other economy. Even if it does not attempt to make progressive changes and improvements of various sorts, if it acts as an economy at all, it must plan for continuity in some form, and specifically must plan to meet changes in conditions beyond its control. It is of the essence of economic behavior to look to the future. And whatever future may be desired, or whatever changes envisaged as inevitable, economic activity involves some planned allocation of the resources available at any moment between use in realizing (in the maximum degree) current objectives and use in numerous activities directed to provision for the future. The maintenance of existing conditions, or even planning for retrogression, involves the same problems in the formal sense as planning for growth or progress in any direction at any speed.

Thus the collectivist economy, in so far as it acts economically, or rationally, must practice capital accounting, in essentially the same way as any private individual or business unit under an individualistic system. As regards the form of planning and management, this implies determining a margin of equivalence between the two general modes or fields of using the resources, namely, current use and investment, in exactly the same way as that pictured by marginalistic capital-and-interest theory for the saving-and-investment activities of individuals and business enterprises. More concrete prediction is again beyond the province of strict economic theory. But it may be observed here, anticipating a later stage of the argument (not developed in this paper), that considerations almost as conclusive in fact as those of general economic logic make it certain that if a collectivist economy actually plans rationally for the future, capital accounting must be much more extensive and important than under individualism. And of course collectivism is rationally advocated, if at all, chiefly on the ground of a more rational planning for the future.

II. The Economics of Collectivism with Reference to Stationary Conditions

In turning to consider briefly the question of what may be said about the concrete character and workings of a collectivist economy, the first and main point for emphasis is (to repeat) that we shift the premises of the argument from those of theoretical reasoning in terms of the abstract meaning of economic activity to empirical considerations of sociology and politics. And with this shift, it goes without saying that all character of a priori certainty in the reasoning is lost. The bare fact of substitution of a collectivistic for a competitive-individualistic form of organization does not logically or necessarily imply any particular change, or even any change

whatever, in the empirical course of social-economic life. Anything that can happen under one organization form could happen under any other, without violating any known law of nature or human nature, to say nothing of laws of logic. In particular, there is no difficulty in imagining that the constitution and laws of a society might be changed from, say, the form which they have in the United States at this moment, to the form of a thoroughgoing collectivism, and that most of the individuals in the country should continue to do substantially the same things and to enjoy the same fruits of their activity, as before. (Rigorously speaking, even advertising men and salesmen of wildcat stocks need not be excepted from this statement, though the form of their activities would of course be very different.)

Any attempt to predict in anything like concrete detail the actual character and course of economic life under collectivism is manifestly absurd. The most general meaning of collectivism is unification of economic life under centralized political control, in contrast with individual freedom of choice under conditions determined by the social-economic status of the individuals and by various prices set by the quasi-mechanical interaction of their choices in various markets. Concrete prediction regarding any collectivist system would involve prophecy as to the conditions under which it would be established, the details of its political organization, and of what either the people or those in authority politically would want to do, think themselves able to do, try to do, and how far they would succeed; or more accurately, how far they would have succeeded at various subsequent points in time. Concrete grounds for prediction are afforded only by what preachers of collectivism have advocated, by what has taken place, or is known or supposed to have taken place, in Russia (or Germany, or some other more or less collectivistic economy), and by general deductive inference, or guessing, as to the probable implications of probable changes in the form of economic organization.

We take up in this section of the argument only the problems of current operation of the collectivist economy, corresponding in a general way to the content of economic theory at the stage of the stationary economy. At the outset, we must emphasize the twofold unreality of the assumptions involved. The stationary economy could not possibly exist, and it is certain that few if any would advocate attempting to approximate it as a matter of policy, in the sense in which that is possible; and in particular, it is as certain as any prediction in this general field of speculation can be that a collectivist economy would center its policy overwhelmingly on rapid and revolutionary change in the very conditions which the stationary hypothesis assumes as given. Adoption of the stationary economy ideal would mean simply the freezing of economic conditions into the forms obtaining at the moment of establishing the new order, and the reason for establishing it is assuredly as opposite as possible to this. Yet for purposes of analysis, it is necessary to

separate the problems of operation under given conditions from those of changing these conditions, and this is just as true for the discussion of collectivism as for that of a competitive economy.

In the scope of this discussion, it is impossible to attempt any adequate answer in detail to the difficult question as to exactly what conditions are assumed as stationary or given. But it is perhaps enough for our purpose to say that by stationary conditions we mean the use of given resources in accord with a given system of technology to realize given ends. Beyond this, it seems justifiable to assume—since we must assume something if we are to say anything at all—that collectivism would maintain the general structure and ideals of society as we know them. In particular, we assume the preservation of the private family in something like its modern form, and assume that the main general objective of economic activity would be the satisfaction of the economic wants of individuals in families, and that they would in the main be allowed freedom of judgment of their wants and preferences. This freedom of judgment has two aspects; freedom of choice in consumption, and freedom of choice of occupation or rôle in production. If we assume that the central controlling authority, the government, acts in such a way as to preserve these two forms of liberty to a maximum degree, within reason, it is not necessary to specify whether the political form is nominally democratic or dictatorial.

We take collectivism to mean what it is ordinarily understood to mean, the appropriation by the government of the great bulk of the productive wealth of society, with the centralization of all functions of economic management which this would imply, and with prohibition of individual accumulation of property in any form not directly useable by the owner for what would be called consumption purposes. The essential point for emphasis at this stage is that, assuming an ideally honest and competent administrative bureaucracy, and assuming that it would be the central aim of policy to approximate the ideal of a stationary economy, the establishment of collectivism would not present any serious economic problems, but neither would it make any very great difference in the course of economic life.

If the state allows individual freedom of consumption, the individual must receive his income in abstract quantitative form, which is to say in money, and the private administration of consumption must take the form of purchasing goods and services made available at definite prices. The ideal of maximum economy in this sense would require that the entire yield of social resources (of that portion devoted to the satisfaction of current needs, in contrast with saving and investment in some form) be made available to consumers at uniform prices. This means that the prices must be such as will clear the market of available supplies; a fairly successful effort must be made to set them at this point, or the system will break down in chaos. That is to say, the prices of goods and services for direct consumption would

be fixed on the short-run, marginalistic principle of maximum demand price for the given supply, taking individual tastes and incomes (purchasing power) also as given, exactly as in an individualistic competitive economy; and the goods and services would also be apportioned among the people in exactly the same way.

Differences between the socialistic and the enterprise economy would be restricted to the content of these three sets of data (supplies of goods, tastes, purchasing power) and to the longer-run conditions controlling them. On the day after the revolution, neither quantities of products nor tastes of consumers would be very different from those of the day before, and if money incomes were different the effect would appear chiefly in different prices. Some redistribution of the product would be possible on the basis of existing stocks, and production could theoretically be reorganized within limits rather rapidly to make possible a new distribution. But a considerable part of the statistical inequality of incomes would disappear through fall in the money value of goods subject to natural scarcity—"choice cuts" of every kind, the proportion of which to more ordinary things remains relatively inflexible over long periods. Unique works of art can only be worth what somebody is able to pay for them and the land and labor which produce a thousand dollars worth of champagne would produce only a fraction of that value in grain, vegetables, or meat.

The postulate of individual freedom of choice of occupation raises the problem of the organization of production. First we may consider the treatment of property resources. In order to predict anything whatever, we must first eliminate by assumption the possibility that the government would exploit its position as a monopolistic owner of innumerable essentials of economic life. This would give it absolute power over every detail of all life, and negate the fundamental assumption of individual freedom. We must assume that it would administer its property resources in accord with the principle of maximum social economy; i.e., would maximize the return from each small increment of each type of resource, measured by product value, fixed by the free choices of consumers. To do this, it would again be necessary to set uniform prices on all property services, and on all labor services as well, and issue them to the ultimate production units in the same or different industries on the basis that the price of the products would cover and no more than cover the prices of the services, and that the available supplies of the latter would be cleared out of the market; that is, the productive services owned by the government would, like products, be priced and apportioned on exactly the same principle as under individualistic competition (the principle of marginal productivity).

The concrete production units—presumably arranged in a hierarchical order of departments, divisions, etc.—would be in essentially the same position as in a competitive individualistic economy. The management of

any unit (whether industry, plant, or division) would have to make a budget in pecuniary terms, with costs balanced against receipts. It would have to be placed in a position, and under effective pressure, to predict correctly the pecuniary results of operations as far in the future as possible up to the period for which commitments would be relatively unalterable. In the sense of economic theory (in contrast with the psychological sense), units would be competing with each other in the purchase of resources, just as consumers would be competing in the purchase of products.[2]

If the given conditions as to wants, resources, and technology are accepted as permanent, most of the property accounting will presumably take the form of rents, i.e., payments for the services of specific productive agencies, but perhaps with maintenance and replacement under the care and charge of the user (the production unit) rather than the owner (the government). But it would hardly be practicable to handle in this way such resources as current raw materials and supplies; these would have to be accounted for in terms of interest. Moreover, within any production unit, maintenance involving periodic replacement could be intelligently carried out only in terms of a calculation of interest, which would ultimately have the same meaning as in competitive theory. And in so far as either expansion or change in the character of production, involving increase of investment or change in its form, comes into the plans, it would be necessary to have capital accounts in the theoretical sense, with a rate of interest expressing the marginal productivity of fluid capital, whether actual payments, and accounting for purposes of payments, take the form of interest or of rent. In all these connections, the future being more or less uncertain, differences between outlay and realized return must constantly occur, and these are, of course, theoretically identical with profit and loss as we understand the terms in individualistic economic theory.

It is already clear that intelligent administration of labor in production, i.e., an organization maximizing value return as fixed by the (competitive) free purchase by consumers under the given conditions at any time, would require the same sort of analytic procedure as in the case of property. We must assume for the moment that this would be administratively possible, without violating the assumption of free choice among occupations by the individual owners of labor capacity. That is, we assume that labor could be allocated to use in accord with product value, leaving for separate consideration the question of the payment of wages and the entire problem of motivation and incentive.

We turn now to the question of distribution, the fixing of the money income of individuals and families. First, as regards the income yield attributable to property, it seems reasonable to assume that the government

[2] They would compete more or less imperfectly and might even exercise a degree of monopoly power.

would take to itself the money value of the imputed yield of the property resources owned by it. What it would do with this revenue would be determined by political considerations, and there is little basis for prediction. It seems plausible to assume that the expenses of administration would be met out of the yield of property (or it would be applied to this purpose as far as it would go, as the case might be). Under the theoretical conditions of the stationary economy, it would be legitimate to assume, as socialists have habitually done, that managerial and administrative problems in a sense distinct from routine labor would be minimal or absent; i.e., that direction and control would lose their political character and be reduced to a technical and statistical basis. This again corresponds to the situation in individualistic theory; under rigorously stationary conditions, the distinctive function of entrepreneurship disappears, being merged into labor in the routine sense in which its remuneration is a competitive wage and not a profit.[8]

This discussion naturally leads back to the topic, sidetracked above, of the relation between the distribution of consumable product among human beings engaged in economic functions and the organization of production in the aspect of allocating human beings to such functions. We may surely assume that a socialistic government would to some extent make the shares of human beings correspond with the value of their productive contributions, where these are measurable with any degree of accuracy, or at least would strive and pretend to do so. This does not mean at all that the distributive share would be made identical with the marginal value-product contribution, which of course is the theoretical ideal of competitive individualism—except as modified by taxation and the distribution of its fruits, saving, and voluntary donations of all sorts (these in fact are fairly large and progressively ever larger modifications).

It is a matter of opinion, and hence largely of wish-thinking, how far the divergence between theoretical contribution and distributive share could be carried without destroying the effectiveness of differences in remuneration as a motive in allocating labor, in stimulating productive efficiency in relation to time and effort devoted to work, and in furnishing an incentive to train for work requiring special training—in so far as this may be a matter of free choice by individual and family. In these connections, the facts of human nature as we know it seem to be quite disconcerting from the standpoint of equalitarian idealism, which has always been a fundamental motif in the advocacy of socialism. Contrary to a common opinion, it seems to me that human beings are decidedly interested in the degree of inequality as

[8] The way in which government used its own money income, to whatever extent drawn from property or from a possible excess of the theoretical product of laborers over the remuneration paid to them, and whether expended directly or through distribution among individuals in any manner, would react upon every feature of the economic adjustment in strict accord with the principles of marginalistic equilibrium theory.

such—in the extent to which they overtop and outshine their rivals, as well as in mere order of rank. Moreover, the losers find a romantic glamor in the splendors (real and imaginary) of the aristocracy. It is doubtful whether there is in mankind at large a real love of equality. And there are still stronger reasons for believing that within wide limits a high degree of contingency is itself important in motivation; the propensity to gamble is surely undeniable, as is the necessity of an element of uncertainty, along with skill, to make any game interesting. We note, too, that the Russian government in its bond offerings tends to place more and more emphasis on lottery features in comparison with a guaranteed (monetary) yield.

These last observations have already carried us beyond the reasonable boundaries of discussion within the strict framework of stationary conditions. But before turning to the problems of growth and progress, we must note that the absence of any difficult or peculiar economic problem under the conditions so far assumed (such as has been asserted by some opponents of collectivism, notably von Mises) is only a part of the case from the collectivist's standpoint. In addition, there are several fundamental respects in which the problems of a collectivist economy would be enormously simplified in comparison with those of a system based on private property. In fact, the concrete evils of the latter system which have currently energized the movement to reject the competitive organization and undertake planning in some form, would be almost entirely absent under a collectivist system, assuming that the government would be ideally competent and would restrict itself to the solution of such problems, and to maintaining as nearly as possible the ideal of a stationary economy. This statement covers three main problems or sets of problems: Money, including most of the problems of cycles and depressions; taxation; and monopoly, including advertising and selling in their objectionable aspects, and overlapping more or less with the cycle problem.

With private property reduced to minimal proportions, speculation would be impossible, the quantity of money directly under control, and the velocity of circulation easily regulated. Since the central authority would also have immediate control over all prices and the movements of productive factors, the whole problem of cycles, i.e., of depression, and specifically unemployment, need not arise, at least not on a scale at all comparable to that met with under individualism. In the taxation problem, we include relief and effective control over individual incomes, upward as well as downward, and the allocation of productive resources, including labor, between private and public uses. Under individualism, the power of regulating distribution by taxation is narrowly limited because society is dependent for the maintenance and growth of its capital supply on voluntary saving by private persons and groups. This difficulty would disappear under collectivism. With regard to monopoly, again, no extended argument is required to show that the prob-

lem need not arise to any great extent, and would be relatively easy to deal with—assuming, always, a competent and public spirited bureaucracy concentrating its attention on these limited problems. It should be noted expressly that the elimination of monopoly carries with it or implies elimination of advertising and salesmanship in all their more exuberant, wasteful, and misdirective aspects.

III. The Problem of Collectivism from the Standpoint of Change

As should be clear from the foregoing, it is under this head that we encounter the real problems of collectivism. The starting point of any relevant discussion of the subject is recognition of the fact that if, or whenever, such a system is established, the reason will certainly be that it is viewed as a superior mechanism for effecting a revolutionary transformation of economic life. Indeed, reasoning on the assumption of stationary conditions can yield no conclusions of practical significance for economic policy, whatever the general pattern of economic organization. Such reasoning is a necessary stage in analysis, but if it stops at that stage it can have no practical relevance. The practical problems of the competitive economy itself arise out of the facts of progressive change, out of the efforts of individuals to better themselves, to get ahead—individually, and in families and other groups whose life extends beyond that of the individual. The essence of collectivism is a project of planning socially, which becomes an objective chiefly because individuals (or primary groups) cannot or will not plan for the future and make their plans known to other individuals and groups as producers. This inability and/or unwillingness to plan is the *raison d'être* of the competitive economy itself, the system of production for the market, or for profit.

These facts in effect take the discussion out of the realm of economics into that of politics. And this observation in turn really constitutes the sum and substance of what the economist, as such, has to say about the whole problem. In so far as any society is collectivistic, the decisions which immediately direct the course of its economic life will be made for the society as a unit, rather than independently by various individuals or functional groups. This is to say that they will be made politically. The actual managers of production and distribution will be working for the government instead of for themselves, and will be chosen, remunerated, motivated, and directed by political process and political agencies of some kind. As to the concrete kind of political process or agency, and what concretely it will do, the economist obviously has nothing to say. It falls within the province of the present discussion only to point out by way of conclusion some of the main problems which the government of a collectivist economy would have to meet and to indicate something of the necessary limiting conditions within which it would operate.

1. We may repeat the main observation of the first part of the paper, that the collectivist economy will confront essentially the same economic problems as any other, and in so far as it solves them economically it will act in accord with the principles of marginalism, since these are the principles of economizing behavior.

2. Any government which owned the bulk of the productive wealth of a society and managed its economic production and distribution would in the nature of the case possess absolute power over the lives of its citizens. Whether such a government could remain democratic, i.e., under the control of its citizens, or how far and in what sense it could do so, is, to say the least, a grave question. If a personal opinion is in order, my own is decidedly in the negative. This seems to me the clear indication both of general reasoning and of the course of events in countries which have been experimenting with collectivistic institutions, notably Russia. The alternative to general coercion is the existence of a consensus in the public mind regarding ideals of life and of social policy which it seems to me clearly does not exist in the degree necessary for the functioning of a democratic political order exercising the control over individual activities which would be involved in administering a collectivist economy. It is to be remembered that under conditions of rapid change there is no possibility of making the remuneration of higher administrative functionaries correspond at all with the economic value of their services and hence of applying economic principles in the selection and motivation of such officials; the methods must be purely political. Moreover, it seems obvious to me that democratic political process itself is inherently competitive and that the substitution of political for business competition would tend to aggravate many of the evils chiefly complained of under the latter; I think in particular of the concentration of power and of the psychological manipulation of the laboring and consuming masses of the people by those in positions of authority.

3. In this general connection, it deserves emphasis that the abolition, or near abolition, of property would exert a transforming influence on the structure of society in matters not generally thought of as directly economic. And possibly it deserves even more emphasis that no one can say what the repercussions in other fields would actually be like. Certainly the structure and meaning of the family and of religious institutions would be profoundly affected. And it must be kept in mind that the motivation of activity in the fields of art, literature, science, invention, and the application of invention, and indeed all cultural activities, has always been closely tied up with property rights on one hand and with family and other face-to-face group relations on the other.

4. The utopian claims of socialists with regard to the changes to result from the establishment of collectivism will not stand the least critical examination. Statistical facts negate the idea of any large, immediate improvement

in the general level of income, even if all the administrative problems were solved in the most ideal way conceivable. Isolating the United States, which is by far the wealthiest of the nations, we note that the income, in the accounting sense, which is imputed to property, is only about a fourth of the total national income, and that the various governmental units now spend considerably more than half of this amount. If income is regarded in the real sense of consumable services, and allowance made for saving, taxation, and other necessary deductions, and for the very large devaluation of intrinsically scarce items already referred to, which would result from an equalization of money income, the fraction of the total represented by property earnings would be reduced by perhaps one-half.

5. On the other hand, the bare fact of the abolition of property would not at all necessarily operate to equalize consumption, and might work in the reverse direction, as it presumably would do in connection with the distribution of power and prestige. It would not be likely to do away with the hereditary transmission of power and privilege, and might make little or no difference in that regard. All such things are a matter of speculation as to the actual workings of political process.

6. It is certain that the advocates of collectivism have been quite naïve in their arguments as to the results which would follow from merely changing the form of economic organization in a society. On one hand, they have greatly exaggerated the significance of economic interests in comparison with other motives and values, and on the other, in the economic sphere itself, they have attributed to the system of organization much which is really due to the vast scale of social relations connected with modern technology, going infinitely beyond the range of primary or face-to-face groupings and to the spirit of material progress which socialists themselves emphasize even more than liberal individualists. They forget that any large-scale organization necessarily becomes impersonal, that in this regard political process resting on campaigning, machine organization, and voting, is fully as bad as market relations reflected in the price quotations of a board of trade or stock exchange. On a critical examination, there is little evidence that large masses of men act together more harmoniously in any other field, or under any other form of organization—be it work or play or the pursuit of intellectual or religious values—than they do in what is called business.

THE PROBLEM OF PRICES AND VALUATION IN THE SOVIET SYSTEM[1]

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When dealing with a problem of Soviet economics, there is a temptation to apply automatically the criteria to which we have been habituated under a different set of institutions, especially when the functions or mechanisms under observation are similar in appearance to those with which we are familiar. For this there is, of course, no justification, as the appearance may well be deceptive. That, however, has actually proved the minor danger. Much more common has been the temptation to rest the case and practically to dismiss it on the ground that our habitual criteria do not apply there.

In particular reference to the price problem, we are confronted by a combination of what may appear as essential similarities and as basic differences, with the possibility that appearances may be misleading either way.

We find pricing omnipresent in Soviet economy. Aside from a limited and diminishing number of public services which are supplied gratuitously or nearly so, the movement of goods and services through the several stages of production and distribution is effected through transactions involving purchase and sale and hire for pay—all at a price. Price intervenes not only in exchanges between individuals, and in exchanges between socialized enterprises and private individuals in the dispensing of goods to individual consumers (even in rationed distribution) and in the procuring of goods from individual producers (even in the shape of compulsory deliveries); but also in mutual exchanges between socialized enterprises, including, above all, exchanges of industrial materials, supplies, and equipment (even when these are, as the bulk of them are, allotted in definite volume to specific industrial consumers). All production and all capital development thus appear as carried on with the view to a sale at a definite price.

An obvious implication of this prevalence of pricing is the existence of an aggregate money income adequate at every stage for the volume of exchanges at definite price levels, and also a distribution of that income such as to assure the availability of purchasing power where and when wanted.

Theoretically, economic growth does not necessarily imply an increase in aggregate money income, as prices may well be imagined so much lowered as to offset the growth of physical volume of turnover. Practically, however, an enormous increase in money income has been assumed both under the first and under the second Five-Year Plans. As that increase has

[1] The formulation of the problem as presented here has been suggested by an inquiry into the financial aspects of Soviet economic planning, conducted by the author with the aid of a grant from the Social Science Research Council.

been reckoned to result from capital outlays incurred, and as it has been the prerequisite for further capital outlays, the program of ever expanding capital development appears as one of cumulative investment for profit.

Prices are accordingly to assure, in the aggregate, an average profit rate adequate to furnish the capital for expansion at the assigned rate.

While, however, the guiding principle is that of having prices assessed at cost plus, there may be, and there have been, indeed, substantial departures from it. Goods may be and have been sold below cost, or else at a price exceeding costs by a much larger margin than the average profit rate; and cost reduction has not been necessarily in every case passed on in full in the shape of reduced prices.

Likewise, the average profit rate is not necessarily secured through a flow, whether free or planned, of capital into the more profitable fields. On the contrary, an outstanding characteristic of Soviet finance has been the diverting of earnings from the more profitable industries or enterprises into such other as are immediately less or not at all profitable but have been planned to be furthered, nevertheless, as a matter of policy. Not only has profitable private enterprise been sacrificed to the program of socialization, but within the socialized economy as well the growth of profitable enterprise has been checked not uncommonly through the use of its profits for the promotion of other activities.

This interference, with a view to redistributing money incomes and to supplying purchasing power, as a matter of policy, where it is not available in required volume as a result of the working of the price mechanism in the first instance, is of the very essence of financial planning in a revolutionary period of economic reconstruction, carried on largely in disregard and in defiance of spontaneous trends.

In every individual transaction the price is evidently conditioned by the purchasing power of the buyer and by the monetary needs of the seller.

While this condition asserts itself in a most obvious fashion where private individuals function as buyers or as sellers, it applies as fully, though in a less apparent manner, to the several socialized enterprises as parties to transactions, whether with individuals or between themselves. Unlike a private individual, a socialized enterprise may well be made to sell at low prices, or to buy at high ones, or both, irrespective of its cost and financial requirements. But, if it is at all to operate and to expand as required under the plan, it can do so only on condition that the losses entailed in the procedure are made up to a sufficient extent by having a portion of the funds accruing elsewhere transferred to it through some of the redistributive agencies.

Among these agencies of redistribution the government budget has been by far the outstanding one in importance. The large place held in the Soviet budget by expenditures classified as serving the "financing of national

economy" reflects precisely the extent of that corrective interference in the distribution of purchasing power. Revenues from taxes levied on individuals, on whatever is left of private enterprise, and on socialized enterprises, from subscriptions to government loans, and from statutory deductions into the budget from the profits of government-owned enterprises, have been applied to finance activities that are not or not sufficiently self-financing, to cover losses, to supplement profits, and to supply funds for capital investment.

Various long-term credit institutions have been designed to perform an analogous function, though on a more limited scale, inasmuch as their operations have been confined to redistribution of incomes within specific economic fields. Outstanding among these institutions has been the Industrial Bank for Long-Term Credit, established in 1927, which was then assigned the function of pooling a portion, fixed by statute, of the profits and of the depreciation funds of industrial organizations, and of using the funds thus secured to advance loans for industrial development. In actual practice this meant at the time the borrowing of some of the earnings of consumption goods industries, then the remunerative ones, for the promotion of heavy industry.

There are, however, obvious limits to the latitude for thus shifting funds. When an economic unit secures additional purchasing power at the expense of another, the assumption is, of course, that the latter can afford it, in the sense that the transfer of funds will not interfere with its ability to operate on the assigned scale, at workable prices. And the freedom of diverting earnings from the more profitable units is evidently limited by the very requirement of an average profit rate. The larger the scale of expansion in non-remunerative or little remunerative fields, the more remunerative must be some other fields, if the program is at all to progress on the assigned scale, at price levels that are attainable and workable.

It has been indeed assumed by the plan that the scope of profitable enterprise will be very rapidly expanding in the very course of its performance. More specifically, the traditional lag of the profitableness of heavy industries, far from being perpetuated, was expected under the first Five-Year Plan to be largely done away with presently, with a steady reduction of losses and growth of profits. Earnings were thus presumed to be accruing to a growing extent within those very fields where they would be required for the expansion as planned. Redistribution of incomes was accordingly to be gradually decreasing in importance, as early as within the first five-year period. The government budget, in particular, while growing in absolute volume, was to have a diminishing share in the financing of economic activities. And, among the budgetary revenues, those derived from earnings of socialized enterprise were to be of growing importance, with a correspondingly diminishing share of revenues from taxation of individuals.

This expectation of profitable operation has been reflected in the part assigned to credit in the financing of the plan. Working capital requirements of the several economic organizations were to be met in part with the aid of short-term bank loans, bearing interest and subject to repayment at maturity out of funds anticipated to become available as a result of the turnover of goods. The State Bank rate, which has been kept unchanged at 8 per cent for many years, performs no regulatory function, and merely serves to cover the cost of operation and to expand the resources of the State Bank by allowing it a share in the expected earnings of its clients. Government loans have been assigned an important place as a source of fiscal revenues, which implies a capacity to meet the growing charges of the public debt as they fall due. The financing of capital outlays in industry was, under the first Five-Year Plan, to be continued largely in the form of long-term loans from the Industrial Bank, with interest and amortization payments due to begin presently.

For the greater part, it is true, funds for capital investments in industry were to be supplied through grants from the government budget, and these had been made, by the time of adoption of the Five-Year Plan, non-repayable and non-interest bearing to the extent of some nine-tenths. Technically and legally, those grants are not credits. By their economic nature, however, they are essentially identical with loans, to the extent that they are designed for the development of enterprises planned to operate at a profit. The expectation of eventual repayment to the public treasury in the shape of taxes and deductions from profits is no less definite, in regard to either volume or time, in the case of those grants than is that of interest and amortization payments on loans. That repayment is no less reckoned upon as a source of revenue in the general financial plan, and its failure to materialize at the assigned time will have effects as disturbing upon the balance of the plan.

In a broader sense, the expectation is identical in either case in regard to the eventual contributive capacity of the enterprise that is financed to the national economy, as expressed in its ability to sell goods at prices not above a definite level, while buying goods at prices not below a definite level.

After all this has been said, however, we are reminded that the entire financial structure, with all it implies in the way of financial plans and policies, rests upon a foundation of prices which are not allowed to be formed freely in a market. Or, if and to the extent that they are thus allowed, they are so by sufferance, subject to a constant possibility of interference by an authority endowed with an unlimited administrative power of regulation in various forms, including the extreme one of price fixing. And when it is further considered that the same authority has an equally unlimited administrative power of control over the bank credit and

currency apparatus, the genuineness of all notions of cost, profits, and capital accumulation may appear subject to some doubt.

The temptation has been strong indeed to rest the case right here and practically to dismiss it with the statement that Soviet prices are "planned," in subordination to the requirements of a planned economy. That statement, however, is hardly conducive to throwing much light upon the function of prices in the Soviet planned economy. It suggests questions rather than affording an answer.

For one thing, pricing obviously involves a restriction of use. If, therefore, prices function as agencies of the economic plan, they must do so in reference to one phase of the plan, to planned restriction, to the plan as a method of discriminating between possible alternative uses.

The fact that prices are planned means that the apportionment of resources is not left to be brought about, in the clumsy and wasteful and not quite effective way that we know, through the spontaneous interplay of uncontrolled market forces, but that the plan is presumed to secure it in a rational manner, by advance calculation. That apportionment, however, and, consequently, the function of planned prices, can be obviously determined by specific objectives of the plan only, not by the mere existence of a plan.

Again, we are confronted by the fact that pricing is not the only method of planned apportionment. The distribution of goods and services is not necessarily left to be determined by prices alone, even as planned. It may be, in addition, directly regulated or fixed, through rationing or earmarking in various forms. It has been so on a large though varying scale, and it may be potentially so on an all-embracing scale. Assuming that all administrative powers are fully availed of, there may appear to be ostensibly no functional relationship between prices and demand and supply. The formula for an individual transaction may appear as follows: at a fixed price, the supply, which is fixed, will equal the demand, likewise fixed. It may well be questioned whether a price problem can arise at all under such circumstances.

Indeed, conformity with the objectives of the plan is the only requirement that sets a limit to the administrative power of fixing the several terms of the equation, and that thus makes pricing a reality rather than a fiction.

The objective of the Soviet plan is of a composite nature, and the one aspect that should be of primary interest in this discussion is that of the plan as a program of economic growth, of increase in the wealth of the community; not because this one phase is intrinsically of greater importance than any other—than the program of socialist transformation, or that of protection against foreign interference—but because it is in this phase that apportionment of resources evidently implies a valuation and a discrimination on the basis of some kind of economic criteria.

The validity, under non-capitalist conditions, and more specifically under Soviet conditions in the present stage, of our habitual criteria of valuation has been questioned seriously and quite legitimately. The consumer's choice as freely expressed in the market may or may not serve as a guide, inasmuch as that freedom of choice may be largely restricted or regulated, and consumption may be directed or regimented. There is hardly a justification for introducing any approach from the standpoint of individual psychology, any calculation of pain and pleasure, of utility and disutility, on the part of the individual, as the motivation behind the plan is not his.

The goal of economc expansion has been conceived in the Soviet plan as what has been described in Soviet terminology as "the building up of a new technical base for the national economy." Ultimately, of course, this is to serve for the satisfaction of consumption needs, but ultimately in time, as it were, not in space, since this service as a leading objective has been deliberately relegated to a future. For a rather protracted period, the promotion of heavy industries and of power development appears as an end in itself.

To appraise the several performances under the plan by imputing to them a value on the basis of that remote satisfaction of consumers' wants would be a rather artificial procedure, with hardly any foundation in current realities. The planner's notion of increase in national wealth is construction of plant and equipment to serve for further construction of plant and equipment. This goal, once taken for granted, carries criteria of valuation of its own as a matter of physical necessity.

It has been the basic assumption of the Soviet plan that at each stage a definite portion of capital outlays incurred at previous stages will be yielding definite results in the way of steadily and very rapidly increasing output of equipment and basic materials, with a similarly growing productivity of labor and economy in the use of physical resources, and that this will be opening a possibility for further expansion along the same lines, at the assigned pace, in the succeeding stages. That is the planner's conception of the current accumulation of an economic surplus.

With the technical level at the outset extremely low, and with virtually no credits from abroad counted on, the entire success of the plan has been indeed premised upon its ability to pay its own way in this manner.

Evidently, not all production of capital goods, nor all construction designed for such production, will be equally paying or paying at all in this sense. It will be doing so as planned and counted on to the extent that its product will be actually put to the planned use. An output exceeding the possibilities of immediate utilization by more than planned, or failure to use the capacity of plant and equipment as fully as planned, or lag of the very construction of plant and equipment behind the planned pace, will mean to that extent a failure of the performance to pay as planned.

The requirement of a currently accruing surplus, as conceived by the planner, is thus identical with that of a properly co-ordinated growth.

The balances involved—that between the several industries, that between current production and new capital development, and that between depreciation and replacement—are not dictated by any abstract principle, nor, of course, as a matter of preserving a static equilibrium. In a period of revolutionary transformation those several balances are bound to be changing swiftly and radically. The only criterion is suitability for effective performance, in regard to volume, pace, yield, and cost.

Restriction of the production of consumption goods in favor of capital goods, while necessarily implied in every program of capital expansion, does not by itself assure that the production of capital goods will be co-ordinated so as to yield currently the required results. Consumption requirements are not the only limit upon the scope of capital expansion; there are, in addition, limits mutually set by the requirements of the several capital goods industries.

Even as far as consumption goods are concerned, no less important than the question as to their total or per capita volume, indeed more important from the standpoint of the prime objective of the plan, is the question as to the proportions in which they and the various resources going into their production shall be allotted to the several activities serving the end of capital development. This, however, is but one aspect of the more general problem of allocating physical resources of every nature, which are by necessity limited.

I believe the only theoretical statement I should feel warranted in venturing in reference to our problem is that the notion of opportunity costs, in that physical sense, applies most fully and in a most tangible manner in Soviet economics. All production does necessarily imply a check upon alternative performance elsewhere. And it is this inescapable condition, combined with the requirement of a proper balance for effective operation, that limits the scope of the plan at any stage. As the performance under the plan progresses, and as it yields returns in the shape of growing output at decreasing cost, the limits are assumed to be steadily widening, from stage to stage, from year to year.

As price planning is presumed to be in accord with the requirements of a growth that is co-ordinated and, therefore, kept within limits, it will be effective if it does make full allowance for the curtailment that is inevitably concomitant with all expansion. In every transaction, command over a definite volume of physical resources is assumed to be acquired and surrendered by both parties, and the volume of both acquisition and surrender is assumed to be both feasible and indispensable.

It is on this condition that the constant changes in price relationships planned to occur in the process, together with a sharp downward trend of

the general price level, will be reflecting the uneven distribution of cost reduction as the results of capital outlays mature in the several fields.

The expectation of an increase in aggregate money income will then appear as an allowance for the limits upon the rate of expansion as set by its cost. Cumulative investment for profit will be but an expression in pecuniary terms of the fact that discriminatory apportionment of resources will be yielding at every stage physical results such as to enable capital development to be carried on, on the planned scale, without interference to the detriment of the plan with current operation, maintenance, and replacement of existing plant, and to permit, in addition, of a vast amount of extra-economic activities.

The shifting of funds and the redistribution of incomes will appear quite consistent with the objective of the plan, within limits. There is no reason why the advantages of cost reduction should be confined to those fields where it accrues and not be spread over the national economy as a whole. And, to the extent that a socialized enterprise is not to secure a share in the economic surplus commensurate with the task assigned to it through the direct working of the price mechanism, to the extent that it is scheduled to leave some of that share with the direct party to the transaction, whether buyer or seller, it may well have the deficiency covered at the expense of some other unit. The only limitation is set by the requirement of co-ordinated expansion.

If, however, planned prices are at all to perform their function thus defined, it is obviously essential that all the restrictive implications of the distribution of purchasing power, whether through the price mechanism or otherwise, be permitted to assert themselves; that is, that distribution of money incomes to the advantage of some units be a means of actually curtailing correspondingly the incomes available to others.

Hence, artificial stimulation of purchasing power, as through bank credit expansion, had no place in the Five-Year Plan as adopted. Bank credit was assigned a very subordinate and modest part in the general financial scheme, a small one out of all proportion with the scope of the economic program. It was designed to serve the financing of what was termed the "most mobile part" of working capital only; that is, seasonal requirements and others of a strictly short-term nature.

Indeed, the entire Soviet theory of commercial bank credit, since this was restored some fifteen years ago, has been a very conservative one, I may say an extremely old-fashioned one; but also, it would seem, the only consistent one, if an equilibrium between prices and purchasing power is to perform its function as a check upon expansion of uneconomical activities. Bank credit was conceived in the shape of advances to some organizations, on a strictly short-term and self-liquidating basis, of temporarily idle

funds of other organizations deposited with the banks. It was to be neutral as far as effect upon purchasing capacity and price levels was concerned.

It is subject to these self-imposed limitations that ability to buy and to sell at a price and availability of purchasing power where and when wanted serves as a check upon the feasibility of the plan as drafted and as a test of its effectiveness as executed.

To come back now to our little, harmonious formula, it appears perfectly correct if the plan proves workable, with the expected results yielded at the assigned time. As long as it does, a fixed supply may be made equal to a fixed demand at a fixed price. This will be an equilibrium price, serving best the objective of the plan, and doing this in a manner so unobtrusive as to give rise to no problem.

If, however, the plan should fail to work at some point, this will be immediately reflected in an inadequacy of purchasing power for the assigned price levels, in inability to buy and to sell at the planned prices, and a price problem will arise. Those will be pecuniary symptoms, denouncing a maladjustment and calling for a readjustment.

The planning authority will be free, of course—in an administrative way—to heed those symptoms or to disregard them, and also free to use such methods of readjustment as it chooses. Whatever course chosen, however, will carry implications of its own.

No man-made plan can be expected to be perfect, of course. Minor maladjustments may be regarded as inevitable, and they may be taken care of by partial revisions of the plan. Maladjustments of a transitory nature can be remedied by temporary departures in regard to prices and the distribution of money incomes. The most rational course would seem to be to make allowance in advance for such untoward developments in the plan itself through limiting the rate of expansion and thus leaving a reserve for emergencies.

In the actual performance of the Soviet plan the maladjustment has proved of a very major and of a lasting nature indeed. It became apparent from the start that the program was much more costly than had been anticipated. The current yield from capital outlays, which had been reckoned to enable the program to pay its own way, was not forthcoming to anything like the required extent, either in regard to the volume of output, in agriculture and in the production of basic materials, or, even less so, in regard to reduction of costs. In the face of this, however, it was chosen to revise the capital development program upward, tremendously in excess of the original provisions.

Pecuniary symptoms of a maladjustment were not lacking from the beginning, and they have been piling up since, in the shape of failure of the expected earnings to materialize, of a heavy financial strain, of a continu-

ously acute shortage of working capital, insolvencies, and a huge floating indebtedness, unpaid bills, frozen bank loans, delays in wage payments, and tax delinquencies.

The effort at a readjustment has borne largely upon the pecuniary phenomena, upon prices, and upon the provision of purchasing power. Financial effort has been designed to enable the capital development program to be carried on in the face of non-fulfillment of its basic premise, through keeping money costs low to the heavy industries and to projects under construction, despite their high physical costs, and through supplying them with a purchasing power, despite their low and delayed yields. In the service of this end, great administrative resourcefulness has been displayed, with considerable, though limited, success.

As far as price policies are concerned, the greatest administrative success achieved in the way of checking the growth of money costs of industrialization has been the virtual stabilization of agricultural prices since 1928, in the face of an enormous rise of prices of manufactures.

A much lesser measure of success has been attained in the effort to keep low the prices of basic industrial materials. While the price reductions provided under the plan could not be carried out, it has been endeavored to enforce adherence to conventionally low prices. Despite all regulations, however, price advances, unplanned, uncontrolled, and illegal, could not always be prevented; prices of building materials, in particular, have been defying control. On the other hand, where conventionally low prices have been effectively enforced, as in the case of fuels and of metals, the result has been a heavy rift between costs and prices in the producing industries, calling for relief from other sources.

Least successful of all has been the effort to secure industrial labor at low money cost through regulation both of prices of life necessities and of wages. Reluctantly, but very consistently, the authorities have been forced by financial requirements of the program to enact successive and very heavy advances in retail prices, with the result that the cost of living has risen enormously, instead of decreasing as planned. Wage regulation has been unable to prevent this from being reflected in advances in wages, although it has been effective in securing a lag of wages behind retail prices and in thus slowing down to an extent the cumulative rise of money costs.

With all its limitations, regulation has succeeded no doubt in keeping price levels lower on the whole than they would have been in its absence. Yet, even with money costs thus kept relatively low, they have been too high for the purchasing power of the industries furthered as derived from their earnings.

Redistribution of incomes to the advantage of those industries has been resorted to freely, and on a scale much larger than had been planned. Among the measures enacted along this line has been the definite substitu-

tion of non-repayable grants for loans from the government budget as a means of financing capital investment in industry, and the canceling of all outstanding indebtedness of industry to the budget, with all interest and amortization charges. Industrial organizations were also freed of the former requirement of maintaining a reserve fund against operating losses. Earnings of the more remunerative industries were for a time diverted nearly in their entirety for the needs of capital development elsewhere, and, by a new departure, the resources of consumers' co-operatives were similarly availed of for the requirements of industrialization.

Yet, by the very nature of the situation, measures of this kind were bound to be of limited yield, and, moreover, they were immediately reflected in further financial strain elsewhere. One outgrowth of the situation has been a heavy expansion of bank credit, of which currency expansion has been but a phase.

Credit expansion went beyond all control following the enactment of the credit reform, early in 1930, when it developed into what came later to be described and denounced as a "wholesale, automatic extension of credit on the security of the Plan"—a plan that was consistently failing of fulfillment—with a growth of frozen bank loans such as to cause serious alarm before the close of that year. In the first half of 1931, the reform was drastically revised by several successive enactments, and the principle was once more proclaimed that bank credit should be confined to strictly short-term loans, mainly on goods in transit and for seasonal requirements, duly secured, and collectable at maturity. The financing of permanent additions to working capital was to come from funds owned by the several economic organizations, with a subsidy from the government budget, when required, in the case of government-owned enterprises.

Since 1932 but few systematic data have been made public in reference to banking developments. However, the fragmentary information available permits a fairly adequate picture to be formed as to the general trends. Expansion of bank credit has undoubtedly slowed down as compared with the first year under the credit reform. Nevertheless, it has continued at a much heavier pace than had been planned. And aside from the volume of credit, material departures from the banking principles enunciated in 1931 have been forced in practice by a succession of emergency situations. The volume of ill-secured and of overdue loans has been heavy, and special loans and extra-plan loans have been repeatedly authorized for a wide range of purposes. Accommodations by the State Bank have thus continued to be accorded on a large scale for the supply of funds outside the limited field assigned to bank credit in principle.

At the same time, as new plants have been completed in growing numbers, and as they have been consistently handicapped in their operations, their working capital requirements have been a steadily growing burden

upon the government budget. Disbursements for this purpose from the budget of 1934 as actually executed reached an amount nearly equal to that expended for fixed capital investments, and the budget for 1935 called for an appropriation for a subsidy toward working capital requirements which is more than 50 per cent larger than the appropriation for fixed capital investments. Thus, as the resources counted upon to be owned by the several industrial organizations have not been available, the burden of working capital financing has been merely shifted from the State Bank to the government budget.

Likewise, and for the same reason, the bulk of fixed capital investment has been forced as a charge upon the government budget. The several long-term credit institutions, above all the Industrial Bank, have come practically to function as mere disbursing agencies for subsidies granted from the budget. The latter has, therefore, been growing in volume at a rate never planned or anticipated, and instead of serving as an agency of redistribution of earnings its function has inevitably become one of assessment of costs.

There was for a time a reluctance to face frankly the fact of non-availability of industrial profits as an important source of budgetary revenues, and attempts were made to get away from it through a variety of technical and administrative devices, some of them of an ingenuity not excelled by any master of financial technique in the capitalist world. Beginning with 1931, however, there has been a surrender to the situation; and it is the turnover tax that has since emerged as by far the most important fiscal and financial agency, increasingly so from year to year, until in 1935 over 75 per cent of all revenues of the federal, state, and local budgets combined were to come from this source.

This tax is levied in the great bulk upon goods dispensed to individuals, primarily consumption goods. Its yield has been growing at a pace out of all proportion with the growth of physical volume of turnover; the proceeds expected in 1935 are twenty-six times as large as the yield in 1927-28 from the earlier taxes which the turnover tax superseded. This growth has been secured by successive advances in rates. The Soviet economic program has been thus led to depend to an overwhelming extent upon a universal excise tax assessed at exceedingly heavy rates upon every necessity of life dispensed to the workers, with supplementary rates on goods going to the peasants.

It is the turnover tax that has been the instrument of that increase in the cost of living that has been enforced contrary to all plans and to all desires of the planners. Its most obvious aspect is precisely that of an instrument in the service of the familiar ascetic phase of Soviet economics, of compulsory saving, of consumers' abstinence.

Asceticism there has been indeed, and with a vengeance. Yet, this should hardly warrant a ready conclusion that the high costs of capital develop-

ment have been met entirely by restriction of consumption, or that low compensation of labor has fully offset its low productivity.

From the standpoint of the individual consumer, a wage earner, or salaried employee in industry, the outstanding fact about the turnover tax is the succession of lags between the cumulative rise in the cost of living which it brings about, and the advances in wage and salary rates which follow. And it is these lags indeed that enable the industries which are furthered to go on expanding and meeting the costs of a growing labor force and of other requirements.

What appears, however, important above all about the mechanism of the turnover tax from the standpoint of the economic objective of the plan, is that it serves, along the same lines essentially as the expansion of bank credit, to supply a cumulatively growing purchasing power to those favored industries, irrespective of their cost, performance, or yield. This, combined with the mechanism of price regulation, which keeps their money costs within limits, has served to remove largely the financial checks upon their expansion.

Those checks are applied quite one-sidedly to organizations engaged in production and distribution of consumption goods, to the extent that they are denied the benefits accruing from the high-price retail market; the lion's share of these benefits goes to the heavy industries. The allotment of the proceeds of the turnover tax has the same effects as the diverting of the profits of consumption goods industries, and also of their depreciation funds, for use elsewhere. There has been indeed a check, and a much heavier one than has been desired, not only upon the expansion of these industries, but also upon their maintenance and operation, and one result has been a shrinkage of profits of some of the leading industries of this class, once highly remunerative, of the textile industries in particular.

Discrimination against consumption goods industries, however, has not been the only one at work. The cost of the expansion has been much heavier than this. With the financial checks upon heavy industries largely removed, handicaps of a purely physical nature have been asserting themselves none the less powerfully. The outcome has been, on the one hand, that enormous growth of plant and equipment which has been described often enough, and, on the other, as an accompaniment and a counterpart, reflecting the cost of the process, a steady accumulation, all along the line, of lags, disproportions, shortages and shortcomings, unfinished construction, unused capacity, wear of plant and equipment, and depletion of resources.

Aside from consumers' abstinence, the costs of the process have been thus reflected in an enforced abstinence of a different sort—of a kind, it would seem, that the poor can ill afford—a spontaneously enforced abstention from the performance of a number of activities essential for the

utilization of the country's productive assets, old and new, and for their very preservation.

The financial mechanisms, therefore, by permitting the expansion to be carried on unchecked, in that ill-co-ordinated manner, in disregard of physical costs, have been directly contributing toward the scattering and the tying-up of resources in unfinished and non-remunerative production and construction.

The vital question is, of course, this: Is it sufficient to remove such automatic checks as operate in a capitalist economy, without substituting any rationally imposed checks, to open boundless facilities for an expansion on any scale, regardless of cost? Or, how far can a process of this nature be carried?

It seems just as impossible to answer this by any deductive method as it is to set a theoretical limit to analogous processes elsewhere, commonly designated by that ugly word "inflation"—a word which I should avoid using as I am not sure whether I know any longer what it means.

All that can be said thus far is that no balance of the performance under the Soviet plan can be drawn. The official Soviet valuation of the new fixed capital in money terms, which runs into the scores of billions of rubles, carries no conviction in this regard, of course, as it reflects the costs of the development, that is, liabilities in the first instance, rather than values as measured by performance.

Those liabilities are a matter of tangible reality. The cumulative physical drawbacks have been constantly and powerfully interfering with the operation of the new fixed capital, and they have been enormously delaying and impairing its yield. The necessity to make up for the things left undone and for the values wasted and destroyed, if that new fixed capital is to operate effectively, represents a charge upon it that is staggeringly heavy —none the less so for the absence of a formal interest and amortization charge. Despite the very impressive physical and technical appearance of the new plant and equipment, no conclusion, therefore, can be drawn in good faith as to whether or not from the standpoint of the prime objective of the plan—that of re-equipping the national economy—there has been a net gain.

It may be suggested that it is the future course of Soviet prices and price policies that should afford the clue to a valuation. In every field, indeed, the price situation as it has developed thus far reflects shortcomings past and present and suggests difficulties ahead.

Retail prices of consumption goods do so in the most obvious fashion. Though disguised by the prevailing shortage of goods, the problem of securing a market for them at the high levels to which prices have been driven by the well-nigh exclusive dependence upon the turnover tax is one of threatening significance. In a succession of futile endeavors to solve it,

the Soviet authorities adopted a few years ago a policy of differentiated prices, on the basis of class discrimination. While the rank and file of the workers were to be assured a supply of at least the prime necessities at comparatively low prices through rationed distribution, prices several times higher were to be charged to the higher income groups in the so-called "commercial" trade. Under the pressure of fiscal needs, however, the commercial trade, started at first on a modest scale, was gradually expanded, and an officially sanctioned flow of goods developed into that high-price market, and away from rationed distribution; at the same time prices in rationed distribution were also being heavily advanced through increases in the turnover tax rates. Class discrimination was thus working, contrary to plans and policies, to the disadvantage of the bulk of the working class and to the advantage of the higher-income groups, which proved, however, to be too limited a market at the discriminatorily high prices. The late reversal from price differentiation to a single price has been designed to broaden the market. The single prices are fixed midway betwen the former commercial prices and what was formerly known as normal prices (those which prevailed in rationed and regulated distribution). To the majority of the workers, those employed at or below the average wage rate, this has meant an advance in prices such as to make a luxury of practically every prime necessity, despite the fact that wages have been more than doubled, on the average, in the past seven years. At the same time, and despite the simultaneous policies of enhanced differentiation in wages and salaries, it is doubtful whether the higher income groups will afford lastingly a broad enough market to absorb goods in a volume and at prices commensurate with fiscal requirements.

No less pressing is the question of agricultural prices. The agricultural program as embodied in the first Five-Year Plan was conceived essentially as one of price policy. The expected contribution of agriculture toward the program was conditioned upon the ability of industry, on the one hand, to equip agriculture adequately and cheaply, and, on the other, to supply the peasants with manufactured goods at sharply lowered prices; thus materially reducing, to their advantage, the disparity between agricultural and industrial prices. It is, in the last account, the early realized failure of industry to live up to either expectation that was responsible for the switch from the policy of commercial stimulation of farming to one of coercion, with the late antipeasant offensive, compulsory collectivization, liquidation of the kulaks, and the losses and charges which resulted. As long as collectivization was carried on as a revolutionary drive, the forced deliveries of agricultural produce at virtually requisition prices were but a phase of civil warfare. With collectivization now completed, and with the revolutionary phase over, the matter of a better price equivalence will be urgently calling for a solution, if the collectives and their members are to yield the

contribution required of them as producers, consumers, investors, and taxpayers.

Finally, the system of conventionally low prices in transactions between socialized enterprises, prices for basic materials primarily, has at no time worked smoothly and has been constantly giving rise to difficulties, which have had to be met by emergency devices. This has been an ever present problem, and its acuteness has been attested on occasions by the violence, not otherwise comprehensible, of the official reaction to even the most timid attempts at bringing it up for public discussion.

It is the ability to solve in a lasting manner these various price problems rather than any technological accomplishments that will afford the test of the adequacy and feasibility of the Soviet program of economic expansion.

DISCUSSION

CALVIN B. HOOVER: These two papers are extraordinarily difficult to discuss together. Professor Knight says, in effect, that marginalism, which he considers to be synonymous with economic theory, is not applicable in a collective economy save on the assumption that the collective economy is stationary. He then demonstrates that the maintenance of a stationary economy would depend upon coercion by the central power. The very essence of a collective economy would, however, consist in the determination to transform the economic life of society, and this transformation could likewise take place only through the employment of state coercion. Thus he arrives at the conclusion that the assumption of the stationary economy under collectivism has no significance, which in turn leaves us confronted by the conclusion that marginalism can afford no guide for management of such an economy as that of Soviet Russia, for instance.

Mr. Gourvitch, on the other hand, describes to us the operation of the system of cost accounting in the Soviet economy. It is perhaps more exact to say that Mr. Gourvitch describes what he considers in effect to be the breakdown of the Soviet system of cost accounting. What we would like to know is whether in such an economy as the Soviet there could be devised a system, or various alternative systems, of pricing or costing or both which would provide an alternative to marginalism as it operates under a laissez faire, capitalistic economy such as that of the United States. The answer might be in the negative, of course, and perhaps this is Professor Knight's answer. Mr. Gourvitch, by his criticism of Soviet cost accounting, implies, however, that there are in existence cost accounting principles which, if they had been adhered to, would have prevented the debacle which he describes. Perhaps by inference one might conclude that Mr. Gourvitch believes that essentially the same type of cost accounting as that used in a capitalistic economy should have been followed by Soviet accountants. If this is his conclusion, then there would be an apparent contradiction between him and Professor Knight, at least upon the assumption that capitalistic cost accounting is founded upon the working out of costs through the operation of marginalism in a more or less free market. This is inference and deduction, however, for unfortunately the two papers do not focus themselves directly upon the same problem.

One might shiver a lance with Professor Knight in the clouds of abstract unreality by discussing whether or not marginalism would apply to a collective stationary economy. But I agree with him that this is beside the point, since an economy which was collectivist by principle would be even less likely to be stationary than would our present form of economy. Since Professor Knight has said that the principles of marginalism would not be significant for a typical collective economy, the question which confronts us is, "What principles would be used in management then?" Apparently Professor Knight's answer would be, "The fiat of authority." Now I quite agree that the making of decisions by an individual who can call upon the coercive implements of the state to put that decision into operation does introduce an element of difference into the economy which is determinative. Nevertheless, the problem still confronts us unsolved. What principles, as a substitute for marginalism, might the Soviet executive use

in arriving at his decision upon which his fiat is based? What system of cost accounting might he use in making estimates upon which the fiat is based, and in estimating the results of the exercise of the fiat? The solution cannot simply be that a collective system is impossible, for one such system exists and functions, however inefficiently. There must be a better or a worse set of principles which would furnish some sort of guidance for the exercise of the power of command.

Mr. Gourvitch's analysis of the dynamic effects of a badly designed and administered system of cost accounting on the Soviet economy is illuminating. It undoubtedly serves to explain to a considerable degree recent changes in price policy in the Soviet economy. I am inclined, however, to question his conclusion that "the ability to solve in a lasting manner the various price problems rather than any technical accomplishments will afford the test of the adequacy and feasibility of the Soviet program of economic expansion." On the contrary, I believe it is largely deficiencies in the technique of physical production which have made the shortcomings of the cost-accounting system really serious. It is perfectly true that bad cost accounting has been a limiting factor on the efficacy of the Soviet productive mechanism.

Professor Knight makes a point by way of parenthesis which I have nevertheless yielded to the temptation of questioning. Unless I have misunderstood him he says that the "more abundant life" could not be attained by means of the redistribution of wealth and income. The question really is, "A more abundant life for whom?"[1]

Those who have advocated the redistribution of income mean one or the other or both of two things. Either they mean that the redistribution of income would be a part of a reorganization of the economy which they believe would increase productive efficiency, or they mean that the poor would be pleased to have some of the income of the rich, or they mean both of these things. Whether the redistribution of wealth would increase or decrease the power of the economy to produce goods and services is, I think, debatable. On the other hand, it seems a perfectly simple proposition that, if any degree of inequality of income whatever exists, the relatively poor would have a more abundant life as a result of taking income from the relatively rich, and transferring it to the aforesaid poor, if it could be done without decreasing total production enough to nullify the advantage obtained from equalization. I agree with Professor Knight that the line of demarcation between property income and other sorts of income is very indefinite. Certainly in the case of a collectivist society which came about through the dictatorship of the proletariat, there would be expropriation of the higher incomes, regardless of whether the income had its source in property, or, say, legal fees.

What further is significant is how much could be taken from the relatively rich and given to the relatively poor without decreasing total production. Professor Knight makes this very point, of course; namely, that he thinks production would be decreased, largely because of falling off in saving. Is the conclusion to

[1] Professor Knight says that I have quite misunderstood his position, and that he intends so to alter his paper as to make his position incapable of misunderstanding. It may be, consequently, that a part, at least, of my discussion is now without point, and that even originally it was based upon misinterpretation.

be, then, that nothing whatever could be done by redistribution of wealth? Do we always have the optimum inequality of distribution of wealth?

That all incomes would still be low even if absolute equality were attained, is not, I think, the most significant point. It is true that a lot of nonsense has been written about the direct result of the redistribution of incomes. It would not mean, as a direct result, a relatively more abundant life for most college professors. But there is at least the possibility that it would mean a more abundant life for an important element in the population, and we are less than realistic if we fail to recognize this. The propagandists of the more abundant life are less than frank, however, if they claim this for the middle income groups as a direct result of income redistribution. Associated with this point is my belief that redistribution of income would affect the utilization of productive resources to the extent that private yachts and the like would not be produced, since no one would have the dollar votes to cast for them even under a system of free markets.

To return to one of Professor Knight's main theses. He maintains that a collective economy would mean the end of liberty. The evidence indicates that he is right; that is, the evidence in the one wholly collectivist economy and the two semicollectivist economies supports this conclusion. But in Soviet Russia, for example, the loss of liberty is in some measure a class loss. The worker in the Soviet Union probably feels lack of liberty little more than a similar worker in a capitalistic country. It is perfectly true that on balance there is far greater liberty for the average person in the United States than in Soviet Russia. But again it must be said that the class character of liberty can hardly be overlooked in considering the survival efficiency of capitalism as compared with collectivism. Personally, I do not for a moment believe that the degree of freedom of the industrial worker is all important. The right of the farmer, the white-collar worker, the professional man, and the business man to liberty is no less sacred than the right of the industrial worker to liberty. I agree that liberty is no less important than provision for material wants, but liberty, if by no means wholly dependent upon provision for material wants, is certainly not independent of it. Our success in escaping collectivism and compulsion probably lies in wide diffusion of both liberty and provision for material wants. It would be difficult to maintain that in our present society these thing take care of themselves.

William Orton: Current skepticism as to the possibility of a rational economic system under collectivism, whether fascist or socialist, falls into two schools which may be roughly indicated by analogy. In the one case you are playing chess under a special set of requirements, which demand that on the second move the queen's knight shall be on bishop three, on the fifth move the queen's bishop shall be on knight five, on the eighth move queen's pawn on queen four, on the tenth move queen on rook four, and so on—all predetermined. Under such circumstances it might perhaps be possible to play a game, and even for a genius to win one; the degree of difficulty would depend on the number, the distribution, the interrelation, and the inherent soundness of the predetermined moves. If they are well planned, the prescription might even confer some advantage on a player who had otherwise no plan at all; but obviously, beyond a certain point the complexity of the game would be so great that the chance of success would be very much impaired. Now this comparison indicates, I think,

the view of the Soviet problem taken by its more friendly critics, by Professor Barone and (unless I misunderstand him) by Dr. Gourvitch.

In the second analogy, you are playing, or trying to play, an ordinary game in a dim light on a board from which all the squares gradually fade out and disappear entirely. The game takes on a nightmarish quality, like the billiard player's doom in the *Mikado*—"on a cloth untrue with a twisted cue and elliptical billiard balls." This is the situation envisaged by Halm, von Hayek, and von Mises. The last named says categorically, "Rational economic activity is impossible in a socialist commonwealth." I think it would be just as true, and perhaps more useful, to say, "Rational economic activity is impossible in an individualist commonwealth" (assuming there could be any such thing as an individualist commonwealth). That contrast will indicate the scope of my contribution to this discussion.

The argument of the Austrian school of skepticism rests on the contention that without free economic activity no workable price, value, or costing system can obtain. There must be not only freedom of choice for present consumer's goods, but for future goods also—a free market for labor, for capital, and capital goods. Without these conditions—all of them—the economic principle (Dr. Knight would say "marginalism") simply breaks down, in both theory and practice. With these conditions a state of balance or harmony or equilibrium results, entailing a maximum net product with a minimum of control.

Now there is so much truth in this reasoning that it is necessary in the first place to examine just what kind of truth this may be. It is always open to the economist to say, "Here is a system of economic equilibrium based on free and rational consumer demands, choice of occupations, distribution of resources, and so on, which on its own postulates is perfectly feasible." All right so long as he stops there. But if he wants to go farther—if he wants to advocate such a system, or to use it as a basis of criticism for some actually existing system—then he must demonstrate that his ideal system does in some meaure correspond to the actual data, or at least that there is a trend in the observable data toward conformity with his postulates. Nothing is more dangerous for economics, or for economists, than to confuse their private ideals with public realities; the history of both the classical and the Marxian schools shows us that; the history of physics shows us the better way. In the current Austrian doctrine there is, I fear, some such confusion; that is why von Hayek is so pessimistic. Listen to him: "In a world bent on planning nothing could be more tragic than . . . the conclusion . . . that persistence on this course must lead to economic decay. Nothing could do more to relieve the unmitigated gloom with which the economist today must look at the future than if it could be shown that there is a possible and practicable way to overcome its difficulties. But it must be admitted that today it seems, to say the least, highly unlikely that such a solution can be found."[1] That is to say, von Hayek looks to find in the observable data a trend toward conformity with his ideal postulates. He cannot find it, because it is not there. By his system of equilibrium not only the collectivist economy, but our own economy (he calls it an "interventionist chaos") stands condemned too. As American

[1] *Collectivist Economic Planning*, pp. 242-3.

slang has it, "That's just too bad." I prefer Dr. Knight's round challenge that the world is not only out of step with him, but out of step with itself; because he goes on to take some practical—though unorthodox—account of the dilemma.

Now although I consider myself a teacher of political economy rather than of economics, I will not follow Dr. Knight through all the spheres of his discourse; but I would like to examine very briefly his marginalism in conjunction with the equilibrium of the Austrians. The notion of equilibrium, I take it, implies a condition of equality between marginal net products; a condition in which the total net product could not be enlarged by a different distribution of resources; in which, therefore, tendencies to disturbance will be at a minimum. Let us note that some process of valuation is inherent in the concept "total net product"; in the neo-classical scheme the valuation is of course that of individuals acting in the competitive free market. Similarly, a process of valuation is implied in the term "marginalism," and is by Dr. Knight similarly conditioned. In this way resources are allocated as between alternative uses, particularly as between the service of present and future needs; and here is the crux of the situation. In the orthodox view, the discounting of the future proceeds on the basis of the individual psychology operating in the free market; and it is precisely this stipulation that collectivism rejects and condemns—to my mind, with very good reason.

I am quite willing to agree with Dr. Knight as to the fundamental importance of the marginal principle; but I do not see why he or the Vienna school is under any obligation to insist that the valuations which underlie the balancing of costs and satisfactions must be exclusively those of individuals. This is the economic equivalent of the political atomism of the French Revolution; and it is everywhere being given up in practice. Why? Because we have found by bitter experience that it does not produce an economic equilibrium. What is a genuine equilibrium? It is essentially a three-dimensional affair, in which time is of the essence. Society is at least as real as the individual of classical economics; and a true valuation of the future from the social point of view is by no means necessarily identical with the discounting of the future made by individuals acting under the pressure of a competitive market. The equilibrium produced under the latter conditions is specious, transitory, and unstable; it is here today and gone tomorrow. We have no right to assume that the allocation of resources between present and prospective needs which results from a purely individualist discounting of the future gives a result which is rational from the standpoint of society as a whole. Dickinson, in the article referred to by Dr. Knight, remarks that the ideal balance of the neo-Classical school bears in fact more resemblance to a socialist than to an individualist utopia; because in that alone there would be a deliberate effort to attain the rationality so glibly postulated by the heirs of utilitarianism. The movement towards collectivism is in fact nothing else than a belated attempt to realize in practice the degree of rationality assumed by the classical economists.

As to how this rationality is to be defined and superimposed on a chaotic world there is endless room for discussion. The second phase of the question is political, and outside our immediate concern; but I must pause to question Dr. Knight's dictum that control means coercion, that therefore extensive economic

change can only come through the seizure of power by some "leader" and his "gang." The essence of democracy is control by consent; if the democracy is intelligent and intelligently led, such control can accomplish very much indeed. Failing that degree of intelligence, there is control by bribery, which is what politics inevitably becomes in a decadent democracy. Some coercion of antisocial elements there necessarily must be in any scheme; the real issue is not the prospect of some degree of coercion, but the definition of the elements to which it is to be applied. Which brings us back to the strictly economic problem.

As to this let me outline, in conclusion, a few theses which seem to underlie this whole question:

1. The discounting of the future, from the standpoint of society as a whole, cannot be left solely or mainly to the play of individualist psychology in a competitive system motivated by the hope of private profit. This has patently failed to produce any stable equilibrium.

2. While there will be a large margin of error in the calculations of any controlling authority, it may not be assumed that the result will be less rational than the outcome of purely individualist forces.

3. The acceptance of net profit as a guide to economic accounting will demand the imputation of certain capital costs by the controlling authority on a different basis from that of individual supply and demand schedules; but this process is no more unrational or unrealistic than the arguments about valuation that beset public utility economics under our existing system. It is essentially a different aspect of the same problem.

4. The acceptance of the net profit criterion on these terms does not mean that all net profit must as a normal rule be individually appropriated and distributed. Individual shares may take the form of security, status, or leisure—equally powerful, and socially more desirable, incentives.

5. In a rational economics, the area within which purely individualist motivation is allowed to prevail will be circumscribed by considerations of public welfare and economic stability. This area will act as a cushion or shock absorber as against the more rigid schedules of price, demand, and supply obtaining in the controlled zone. This conclusion is however much less drastic than it sounds in as much as both demand and supply are naturally less elastic and more predictable for the basic social services than for specialized consumption goods, and the corresponding conditions for capital can be made so.

6. Granting the probability of a high margin of error in the exercise of economic control, there is a better prospect of economic progress than under circumstances in which economic errors of international magnitude and lasting consequence are perpetrated for the sake of a transient political expediency, or the passions of the mass-mind responding to high-pressure salesmanship and private propaganda. The development of the collectivist approach to social life offers a better chance that problems which are in essence purely economic will be recognized and dealt with as such.

MICHAEL T. FLORINSKY: It is much easier to discuss a subject when one disagrees with the principal speakers but I find myself in complete agreement with what has been said here by Professor Knight and Mr. Gourvitch. Professor Knight has given us a brilliant, penetrating, and challenging analysis of the

chief factors and ideas involved in the communist approach to problems of price and planning. There is nothing I could add to Professor Knight's address. But I would like to emphasize the fact that, in accordance with communist doctrine, the abolition of private interests and private property is the necessary preliminary condition for the introduction of a planned economy. The communist writers regard as impracticable, silly, grotesque, and ridiculous any attempt to fit economic planning into the framework of a capitalist society. Whether successful economic planning is at all feasible is not a question I propose to discuss here. One should, however, always keep in mind that an effective political dictatorship and the elimination of opposition from private interests is considered by the communists—and I think rightly so—as a necessary prerequisite for economic planning.

Mr. Gourvitch has given us an illuminating and thoughtful statement of the price-making process under Soviet conditions. The question of prices is one of the most important and also one of the darkest in the entire field of communist economics. The few articles dealing with this fundamental subject which have appeared in Soviet periodicals throw practically no light on the actual process of price-making in Soviet Russia. Last year a high official of the central Soviet planning body was lecturing in the United States. I attended one of his conferences and asked him to give me some idea of the method by which the actual prices inserted in the Five-Year Plan and other documents are arrived at. The answer I received was that this was a very difficult thing to explain. And that, of course, I knew before. Mr. Gourvitch has made it clear that, in the Soviet Union, prices are being manipulated in such a manner as to encourage the output of production goods, and that the turnover tax which provides the bulk of the funds needed for further capital investment is borne largely by consumers goods. It does not seem certain that even this policy—a policy of encouraging the development of certain branches of production at the expense of other branches in accordance with the plan—is consistently carried out in the question of prices. One of the few discussions of the subject I know of is given in an article by a Soviet economist, S. Turetsky, which appeared in *Planovoe khozyaistvo* (Planned Economy), No. 4, 1932; that is, at the end of the first Five-Year Plan. M. Turetsky points out that even for goods of the same class there is often no connection whatsoever between the cost of production and the price. He states that in 1931, taking the cost of production as 100, the prices of machines, machine tools, and metal goods, varied within the wide margin of from 65 to 200. The Soviet economist rightly remarks that the question of favoring one type of goods as over against another did not arise in this case. On what logical or economic grounds, for instance, could one explain the puzzling fact that pincers were sold at a price 35 per cent below cost, and files at a price 35 per cent above cost? M. Turetsky's answer is that the differentiation in prices was not infrequently due to the "irrationality, negligence, and wastefulness" of the planning bodies, which seems to me a reasonable explanation. And the question of cost of production in a communist economy presents immense and all but insoluble difficulties.

Mr. Gourvitch has said that he tried to avoid the use of the ugly word "inflation" because he was not sure whether he knew any longer what it meant. My own limitations are even greater, for I am not sure whether I know any longer what is meant by planning. Planning in the Soviet Union, I think, means

something very different from the kind of planning extolled by many so-called radicals outside the U.S.S.R. Planning in the Soviet Union means a great concerted effort for the achievement of a certain definite purpose, such as the building up of the machinery of production, the collectivization of agriculture, and so on. This planning is much more in the nature of a drive than of a blueprint all the parts of which are carefully co-ordinated. This is why, as everybody knows, certain parts of the first Five-Year Plan have been largely overfulfilled, while others lagged behind, without any particular ill effect. Overfulfillment, indeed, is always held as a great victory. I am perfectly aware of the immensity of the task undertaken by the Soviet government and of the fact that eight years is a very short time to pass a final judgment on the ultimate value of so gigantic an enterprise. I have real admiration for the courage and perseverance of the Soviet leaders, although I often doubt their wisdom. But one cannot escape the conclusion that the Soviet experiment offers no guidance to the capitalist nations. There is no indication so far that the communist system will succeed in harnessing the great economic forces which rule our complex civilization. It is one thing to build at a tremendous sacrifice a huge machine of production; it is an entirely different one to be able to run it successfully. The official claim of the Soviet government that the U.S.S.R. is immune from the evil effects of the depression is entirely without foundation. A cursory examination of the figures of the Soviet foreign trade for the last few years will suffice to indicate that Soviet exports and imports were affected by the depression in exactly the same way as the exports and imports of the capitalist countries.

In the early months of the Soviet rule Lenin proclaimed, "We must learn from the capitalists how to organize the Socialist State." The imperfections of the capitalist system are flagrant and we are all aware of them. Nevertheless, I am by no means certain that the dictum of the great Russian revolutionary leader is not just as true in 1935 as it was in 1918 or 1919.

THE EFFECT OF NEW DEAL LEGISLATION UPON INDUSTRIAL RELATIONS

DAVID A. McCABE, *Chairman*

The discussion centered about the effects of the National Labor Relations Act on industrial relations, with some consideration of the collateral effects of the Social Security Act. Constitutional issues were waived for purposes of this discussion.

Professor H. A. Millis opened the discussion with a summary of the National Labor Relations Act; his special topic was the effect of subsection 8 (5). The requirement of recognition by the employer of the representatives of the majority and conference with them does not involve or would not naturally lead to compulsory arbitration. The statute "calls for nothing beyond what wise management would concede or the general public expect." To the extent that this provision will cause employers to receive and confer with the representatives of the majority who would not otherwise have done so without recourse to strike by the workers, it makes for industrial peace. However, it will face many difficulties, including the possibility of involving the Board in the necessity of passing on claims of rival unions and so "determining to an extent the form labor organization shall take." The administration of this provision may break down in the face of persistent evasion of real compliance by a large number of employers; it may be difficult to bring proof satisfactory to a court that the employer is avoiding complying with an order to take positive action in a matter in which judgment enters so largely. In the end any substantial change in practice in big industries opposed to unionism is likely to depend more upon the exercise of union power than upon this particular change in the law. On the whole the statute is commendable as an attempt to give protection to the workers' right of self-organization and to promote collective bargaining. But it calls for greater recognition of its obligations by organized labor.

E. S. Cowdrick spoke on the effect of the National Labor Relations Act upon employee representation plans. He stated that the development of employee representation was an evidence of and contribution to "the growth of confidence and understanding between employers and employees" in this country in the past twenty or thirty years. The Act is obviously intended to eliminate such relationships; it proceeds from an assumption that confidence and understanding between an employer and his employees is "evidence of something sinister." Because employee representation plans do not conform to the characteristics of labor unionism—which they were never intended to, not being based on an assumption of conflict between management and workers—"official Washington" is apparently determined to destroy them or to force them to change into a "mere inferior imitation of labor unionism"; ironically enough it is trying to turn them into the "company unions" with formal organization which they were not and were never intended to be. The recent legislation has led to increased attention to personnel policies and foreman training. There has been a tendency also toward more independent action by the employees, such as regular meetings of employee representatives with no company officials present; "it has become standard practice to have elections conducted wholly by employees"; in many companies the workers "have the right to amend, without the consent of the

management, those parts of the representation plans which concern the machinery for collective bargaining." Generally these procedural changes have had the full consent of management. Written contracts between management and employees—anticipated in substance by the memorandum of agreement found in some of the earliest plans—are also increasing. Thus far the effects of increased formalization of the results of collective bargaining have been neither noticeably good nor bad. There has also been a perceptible tendency toward more formal organization on the employees' side, sometimes with membership dues; this tendency is more noticeable in the newer plans. This is a backward rather than a forward step, a lessening of the constructive benefits of employee representation plans. There has been some increase of a practice, not wholly new, of meetings of employee representatives from all the plants of a company. The balance of the total effect of the Act is on the negative side so far. There are many evidences that workers will not readily abandon relationships and methods which have established over long periods their value and effectiveness. The reality of collective bargaining under employee representation plans has been proved by twenty years of experience; substantial benefits have been achieved which the employer in many cases had originally no intention of granting; wages in the mass-production industries characterized generally by the "open shop" are on the average better than in most unionized industries.

Dr. David J. Saposs spoke on the same topic and said that a survey of employee representation plans, rightly called "company unions" because they cannot take any final decision independently of the company, shows that they are generally no more than consultative bodies. The larger number of these plans has been introduced since the passage of the Recovery Act, and on employer initiative. Recently there have been some modifications in procedure in many of the plans and some others have undergone a reorganization. One noticeable change has been the dropping of the preamble setting forth why the company is establishing the plan. Most of them are in conflict with the Act, in that the Act makes the organization of the workers, even the initiation of their organization, the concern only of the workers themselves. The changes which have been introduced do not make them real collective bargaining agencies; the workers cannot bargain collectively unless the workers as a body can make a decision—this is the test, not the terms granted the workers by the employer at his own discretion—and under the general run of plans there is no provision for a membership meeting of the workers themselves to take action, as distinct from separate meetings of the representatives; moreover, the plan in most cases still leaves the final decision with the higher officials, presumably on the assumption that they are "above the battle"; this is the reason that the employer does not want to make a written agreement with the workers as a body.

Professor Carroll R. Daugherty directed his remarks to the topic of labor relations attitudes under the National Labor Relations Act and the Social Security Act. Most of the executives in the large and dominant nonunionized industries have turned to some form of employee representation for the redress of grievances; some of these, like those who have had such plans for years, are convinced that these plans are good in themselves and serve as more than bulwarks against unionism. American industrial executives are still predominantly antiunion. Under the objective conditions of "business and politics as usual" the

majority will, if the Act is upheld, discontinue all but the subtlest repressive measures in the face of organization attempts and give attention to the welfare measures left to them by the Social Security Act. Subsection 8 (5) will not in the face of this attitude result in real collective bargaining; only strong unions in their industries can bring that about. "Foremen must be taught how to substitute tact and smoothness for crudeness and toughness." If the threat of strong unionism does develop, the employer opposition to the social security program will be lessened in the hope of keeping the workers' minds on state benefits and off outside unionism. The industrial union exponents will try to entrench themselves to get the sanction of the Board as collective bargaining agencies ahead of the craft unionists but will be more likely than the latter to resort to direct action if the Board's decision goes against them. There will be a movement toward greater intra-union democracy, which may be followed by a drive for national union control to curb outlaw strikes and secure the observance of agreements; the importance of education of the rank and file will be increased. The workers themselves will probably "be more amenable to unionization than during any other non-emergency, non-crowd madness period." The chances of the unemployed becoming allies of the unionized workers rather than enemies are at least even. The shift from compromise-seeking mediation to quasi-judicial settlements in terms of law will mean an immediate loss in terms of good will and understanding but a gain in settlements on the basis of democracy and fairness. In time these changes in law will probably lead to governmental intervention and regulation of internal organization and functioning and restrictions on striking. The importance of political action by organized workers will be increased.

Dr. W. M. Leiserson stated that the inclusion of subsection 8 (5) in the National Labor Relations Act may not achieve the end sought. There is so much misunderstanding and confusion about what collective bargaining means that the courts may find this provision too vague to enforce. The Railway Labor Act way of putting it is much better; the emphasis should be on the duty to confer and attempt to reach agreement. The absence of any mediation provisions reflects a lost opportunity to bring about real collective bargaining in many cases. However, the statute will help to impress upon the public the need of collective bargaining. If there is real collective bargaining, there should be written agreements embodying the results; written agreements do not necessarily indicate a lack of confidence between the parties. An employee representation plan which excludes agreements covering wages and other terms of employment is not an agency of collective bargaining. It is not collective bargaining if the workers' representatives have only a consultative function. During the depression employers who had employee representation plans generally abandoned consultation and merely announced wage cuts. By contrast the handling of the wage issue by the railroads and their employees' organizations since 1929 illustrates real collective bargaining; that experience, both cuts and restorations of pay, was the result of the practice of written agreements and the legal duty to confer on proposed changes.

W. B. Catlin stated that the willingness or reluctance of the workers themselves to join independent organizations is fundamental. The possibilities of cooperation and harmonious relations in the plants between workers, members of outside organizations, and the management should be emphasized.

MINUTES OF THE BUSINESS MEETINGS OF THE AMERICAN ECONOMIC ASSOCIATION HELD IN NEW YORK, NEW YORK, DECEMBER 26-28, 1935

The first business meeting of the American Economic Association was held at 9:00 A.M., December 27, 1935, in the Hotel New Yorker, New York, President Clark presiding.

The minutes of the meeting of December 29, 1934, were approved as printed in the *Proceedings of the Forty-seventh Annual Meeting*, pp. 198-200.

The following reports were read and approved:

1. The Secretary. (See p. 297)
2. The Managing Editor. (See p. 302)
3. The Treasurer. (See p. 304)
4. The Auditor. (See p. 305)
5. The Finance Committee. (See p. 310)

President Clark appointed Professors Roy G. Blakey, of the University of Minnesota, Truman Bigham, of the University of Florida, and Max Wasserman, of Washington, D.C., as a Committee on Resolutions.

Professor Walter Willcox, as representative to the American Council of Learned Societies, made an oral report on the activities of the Council and referred the members to the account of these activities as printed by the Council.

A report from the Joint Census Advisory Committee was read and approved. (See p. 312)

Adjourned.

The second business meeting of the American Economic Association was held at 9:00 A.M., December 28, 1935, in the Hotel New Yorker, with President Clark presiding.

The minutes of the previous meeting were read and approved.

As a representative to the Social Science Research Council, Professor H. A. Millis presented a report of the activities of that body for the past year. The report was approved. (See p. 315)

The Social Science Research Council requested an expression of opinion by the members of the Association on a proposal submitted by it. The Council is seeking an endowment and believes that if the constituent societies should name a panel of persons from their respective memberships from which the Council could select its representatives, it would facilitate the accomplishment of its purposes.

Voted: That the American Economic Association express its sympathetic interest in the proposed plan, and refer the question to the Executive Committee with power to act.

Voted: To grant leave to print a report from the representative of the Association to the Business Research Council.

The following report of the Committee on Resolutions was unanimously adopted:

WHEREAS, The members of the American Economic Association in attendance at the Association's Forty-eighth Annual Meeting in celebration of its fiftieth anniversary in New

York City, December 26-28, 1935, desire to express formally their gratitude to those who have been chiefly responsible for the success of the celebration; therefore be it

Resolved, That the Secretary be directed to tender to Professor B. H. Beckhart, of Columbia University, chairman of the Committee on Local Arrangements, and to each of the members of the Committee, the thanks of the members of the Association for the splendid manner in which the arrangements for the meeting have been handled; and be it further

Resolved, That we express our appreciation to President J. M. Clark, Secretary F. S. Deibler, members of the Program Committee, and other officers of the Association, for their untiring work in arranging so successfully an appropriate fiftieth anniversary program; and be it further

Resolved, That we extend to the management of the Hotel New Yorker, particularly to its manager, Mr. Howard Hohl, our thanks for having co-operated with the officers of the Association in such a way as to insure the success of the meeting; and be it further

Resolved, That our thanks be expressed also to the press for the publicity given to the program and activities of the Association; and be it finally

Resolved, That the members of the Association express their gratitude for the foresight of the founders in establishing and fostering a national organization of economists and that they also felicitate the Association on its unusual good fortune in having present at the fiftieth anniversary meeting four of the charter members: Professors J. B. Clark, D. R. Dewey, R. T. Ely, and E. R. A. Seligman.

ROY G. BLAKEY, *Chairman*
TRUMAN C. BIGHAM
MAX J. WASSERMAN

The certification of election was then presented:

In accordance with the by-law on election procedure, I am hereby certifying the results of the recent balloting, and am including the report of the Nominating Committee and the Committee on Elections.

The Nominating Committee, consisting of Edwin F. Gay, Harvard University, chairman; Eliot Jones, Stanford University; Glover D. Hancock, Washington and Lee University; Edwin G. Nourse, Brookings Institution; R. C. McCrea, Columbia University; and Harry D. Gideonse, University of Chicago; presented to the Secretary the following list of nominees for the respective offices:

For President
Alvin Saunders Johnson
Harold Glenn Moulton

For Vice-Presidents
William Henry Kiekhofer
Ernest Minor Patterson
Isaiah Leo Sharfman
Albert Benedict Wolfe

For Executive Committee
Alzada Comstock
Ralph Cecil Epstein
Robert Murray Haig
Alvin Harvey Hansen

For Social Science Research Council Representative
Frank Hyneman Knight
Joseph Henry Willits

The Committee on Elections prepared biographical sketches of the various candidates and ballots were distributed early in November. The canvass of the ballots was made on December 21, 1935, and the results were filed with the Secretary.

From the report of the Committee on Elections I have the following information:

Number of ballots returned without proper identification and not counted	22
Number returned too late for counting	9
Defective ballots	2
Number of legal ballots	1075
Number of returns from the mail ballot	1108

On the basis of the canvass of the votes cast, I certify that the following persons have been duly elected to the respective offices:

President (for the term of one year)
Alvin Saunders Johnson

Vice-Presidents (for the term of one year)
Ernest Minor Patterson
Albert Benedict Wolfe

Members of the Executive Committee (for the term of three years)
Robert Murray Haig
Alvin Harvey Hansen

Representative to the Social Science Research Council (for the term of three years)
Frank Hyneman Knight

Adjourned.

REPORT OF THE SECRETARY OF THE ASSOCIATION FOR THE YEAR ENDING DECEMBER 14, 1935

The report submitted herewith includes the minutes of all meetings of the Executive Committee held within the year.

1. Minutes of the first meeting of the 1935 Executive Committee:

The minutes of the first meeting of the 1935 Executive Committee were printed in the *Proceedings* of the 1934 annual session of the Association, p. 203.

2. Minutes of the second meeting of the 1935 Executive Committee:

The second meeting of the Executive Committee of the American Economic Association for the year 1935 was held at the Brookings Institution, Washington, D.C., March 16, 1935, at 2:00 P.M. There were present: President Clark, presiding, and Messrs. Barnett, Deibler, Dewey, Knight, Millis, Mitchell, and Williams.

Voted: To approve the minutes of the meeting of the Executive Committee held in Chicago, December 29, 1934, as printed in the *Proceedings* of the 1934 meeting, p. 203.

Voted: That the Secretary advise the Commission on Public Service Personnel that the Executive Committee of the American Economic Association endorses in principle the report of the Commission and that a special committee will be appointed to study this report and to make to the Executive Committee recommendations of appropriate action that may be taken by the Association.

Voted: To refer the request of Professor Seligman concerning an appropriate review of the *Encyclopaedia of the Social Sciences* to Dr. Dewey with power to act.

Voted: That the following proposed amendment to the constitution of the American Council of Learned Societies be ratified:

> To Art. 3 add the following paragraph: (d) Any member of a constituent society not otherwise a member of the corporation who may be elected to a constitutional office of the Council, but such ex-officio membership shall be only for the duration of the term of office.

Voted: That David Friday be appointed as a representative from the American Economic Association on the Board of Directors of the National Bureau of Economic Research.

Voted: That the question of handling publicity at the time of the annual meetings be referred to the Secretary with power to act and that he be authorized to incur expenses not to exceed $200 in carrying out plans if this seems to be in the interests of the Association.

The Committee on the Organization of the Offices of the Association presented the following report and recommendations:

The Committee has given careful consideration to the various issues involved, and submits to the Executive Committee the following recommendation:

1. It is recommended that the offices of Secretary-Treasurer and Editor of the *Review* be consolidated as soon as practicable and be placed in charge of a full-time man.

2. It is recommended that the activities of the Association be broadened and developed along such lines as the following:

   a) Resumption of the publication of monographs;
   b) Promoting research of types requiring co-operative effort;
   c) Setting up regional organization for meetings and discussions of research;
   d) Developing more effective affiliations with research organizations abroad;
   e) Stimulating more effective graduate training along research lines; and
   f) Broadening the contacts of the Association and extending the influence of the *Review* and other publications.

3. It is recommended that the headquarters of the Association be established in Washington.

4. Inasmuch as the success of the enterprise depends primarily upon the qualifications of the individual who is placed in charge, it is recommended that attention should be given to the appointment of a competent person who would combine editorial, executive, and promotional abilities. In order to make possible the most effective development of the work over a period of years, it is believed to be desirable to appoint someone between the ages of thirty-five and fifty years.

5. It is recommended that a subcommittee be appointed to raise the necessary additional funds, the estimated annual minimum requirement being $5,000. The essential financial facts may be summarized as follows:

The sum of $1,000 is now being paid to the Secretary-Treasurer, and $2,500 to the Editor.

The Association has an annual surplus of approximately $1,000. Personnel economies incident to the consolidation would save perhaps $500. This makes a total available of approximately $5,000. The requirements for the program are estimated as follows:

For salary of Secretary-Treasurer-Editor	$ 7,000
For research committee	1,500
For rent	1,500
	$10,000

The minimum additional requirements would, therefore, be $5,000. In the judgment of the Committee, a sum of $7,500 a year for five years should if possible be raised.

F. S. DEIBLER
EDWIN F. GAY
MAX HANDMAN
H. G. MOULTON
H. A. MILLIS
J. M. CLARK

Voted: That the recommendations of the Committee proposing the locating of the headquarters of the Association in Washington, under the management of a full-time Secretary-Treasurer-Editor be approved, but that the figure in the last sentence of the report should be increased from $7,500 to $10,000.

Voted: That J. M. Clark, Edwin F. Gay, and H. G. Moulton be appointed a Special Finance Committee to solicit funds for effecting this program.

Voted: That this Special Finance Committee be authorized to canvass the situation and to nominate to the Executive Committee a person properly qualified for the position of Secretary-Editor and to specify the appropriate salary.

Voted: That in the event the offices are moved to Washington, the Secretary-Treasurer be authorized to defray the expenses involved in the transfer of the archives to the new headquarters.

Voted: That the Special Finance Committee together with the new Secretary-Treasurer be authorized to select the location of the new offices and to make the proper lease.

Voted: That an audit of the books of the Association be authorized at the termination of the services of the present Secretary-Treasurer and that the transfer of the property of the Association be made at the convenience of the new Secretary-Editor and the present Editor and the Secretary-Treasurer.

Voted: That the resignation of Mr. George B. Roberts as a member of the Finance Committee be accepted and that Mr. Charles C. Wells be appointed to the vacancy thus created.

Voted: That the publication of the *Handbook* be suspended for the current year.

Voted: To confirm the choice of New York as the place for holding the next annual meeting.

Voted: To fix the dates of the meetings from noon, Thursday, December 26, through the evening of December 28, 1935.

Voted: To authorize the President and Secretary to select a chairman of the Committee on Local Arrangements.

The Editor of *The Social Studies* requested the Association to name a person to be appointed on the Board of Editors of this journal.

By a four to one vote, the request was laid on the table pending further inquiry as to the character of the publication.

Professor Broadus Mitchell requested that his vote be recorded in the negative.

Adjourned.

3. Minutes of the third meeting of the 1935 Executive Committee:

The third meeting of the 1935 Executive Committee was held at the Hotel New Yorker on December 26 at 5:00 P.M., with the following persons present: President Clark, presiding, and Messrs. Barnett, Deibler, Dewey, Knight, Millis, Mitchell, and Thorp.

Voted: To approve the minutes of the second meeting of the 1935 Executive Committee held in Washington, March 16, 1935.

Voted: To accept the resignation of Edmund E. Day as a member of the Joint Census Advisory Committee.

Voted: To appoint William G. Ogburn to fill the unexpired term of Dr. Day on this Committee.

Voted: To reappoint Leo Wolman to succeed himself as a member of the Joint Census Advisory Committee.

Voted: That the Secretary be authorized to have devised and to purchase an appropriate corporate seal for the Association.

Voted: That Meredith B. Givens and Willard Thorp be named to serve with Morris Copeland as a committee to study the report of the Commission on Public Service Personnel, and to report appropriate action to be taken by the Executive Committee.

Voted: That the President of the Association be authorized to indicate special round table sessions for which the expenses of mimeographing papers in advance of the meetings will be borne by the Association.

Voted: To confirm the appointment of C. E. Ayres and Morris A. Copeland to the Editorial Board, terms to expire in 1937.

Voted: That it is the sense of the Executive Committee that the terms of office of members of the Editorial Board shall be for a period of three years, and shall be arranged so that the term of two members will expire each year.

Voted: That the Executive Committee does not regard its right of prior publication as preventing Professor Frank Knight from publishing in a more elaborate and extended form as a separate pamphlet the paper which he read at one of the sessions of the present annual meeting.

Voted: To authorize the Secretary to publish in full in the *Proceedings* all main papers presented at the present annual meeting.

Voted: To defer action until the spring meeting of the Executive Committee on resolutions pertaining to the purchase and sale of securities held in the investment account of the Association.

Adjourned.

4. Minutes of the fourth meeting of the 1935 Executive Committee:

The fourth meeting of the 1935 Executive Committee was held in the Hotel New Yorker at 12:00 M. on December 28, 1935.

There were present: President Clark, presiding, and Messrs. Barnett, Deibler, Dewey, Knight, Millis, Patterson, Thorp, and Williams.

Voted: To approve the minutes of the third meeting of the Executive Committee as read.

Professor Robert D. Calkins, of the University of California, was invited to appear before the Committee to speak in behalf of a proposal made by him to the effect that the Association should undertake to reprint articles of particular interest to graduate students that have appeared in the *Review*, the *Quarterly Journal of Economics*, and the *Journal of Political Economy*. Professors Taussig and Viner, representing the *Quarterly Journal of Economics* and the *Journal of Political Economy*, respectively, were invited to participate in the discussion.

It was the sense of the combined group that the suggestion was meritorious, particularly as applied to articles on theory. Two proposals were considered: 1. The reprinting of individual articles. 2. The publication of a collection of articles in book form. After a considerable exchange of views the following action was taken:

Voted: That the President be authorized to appoint a committee to investigate the character of articles which might be reprinted and the probable demand, and estimates as to costs, and to report its finding to the March meeting of the Executive Committee.

Voted: To authorize the Secretary to investigate the possibility of cheaper methods of publishing the handbook.

Voted: That the Joint Committee on Statistics of Incomes be continued and that an appropriation of $150 be made to defray the travel expenses of the members of the American Economic Association on this Committee.

Voted: To appoint C. H. Crennan, C. C. Wells, and F. S. Deibler the Finance Committee of the Association for the year 1936.

Voted: That the Secretary be instructed to notify the editor of *Social Studies* that his request to have the American Economic Association appoint an economist to serve on the editorial board of *Social Studies* is contrary to the general policy of the Association and, therefore, the Executive Committee regrets that it cannot comply with the request.

Voted: That the Secretary be instructed to act with the secretaries of the social science associations in arranging the place for holding the next annual meeting.

Voted: That the Secretary be instructed to notify the National Public Housing Conference that it is contrary to the policy of the American Economic Association to adopt resolutions of the character submitted, and, therefore, the Executive Committee regrets that it cannot comply with the request to endorse the resolution submitted.

Adjourned.

The office of the Secretary has conducted the regular business of the Association during the current year, including the editing of the *Proceedings*.

The President made the following appointments during the year:

Nominating Committee
- E. F. Gay, Chairman
- Eliot Jones
- Glover D. Hancock
- E. G. Nourse
- R. C. McCrea
- Harry D. Gideonse

Comittee on Elections
- Chester Wright, Chairman
- Reuben Cahn
- F. S. Deibler

Auditor
- Frank E. Kohler and Company

Committee on Local Arrangements
- B. H. Beckhart

Meeting of American Academy of Political and Social Science
- Lewis L. Lorwin
- R. A. Brady
- David J. Saposs

Meeting of American Home Economics Association
- Mrs. Helen Fisher Hohman

Special Committee to study report of Commission on Public Service Personnel
- Morris A. Copeland

In accordance with a resolution of the Executive Committee (Vol. XX, Sup. 1, p. 184), the President and Secretary approved the use of the addressograph list of the Association by:

H. Morton Bodfish, U. S. Building and Loan League, to send our pamphlet entitled, "The Depression Experience of Savings and Loan Associations in the United States."

The following table shows the present status of the membership and the changes that have occurred during the year ending December 14, 1935, the date of closing the books of the Association:

Total members and subscribers in December, 1934			3572
Annual members in December, 1934		2433	
Members removed in 1935:			
Resigned	60		
Lack of address	15		
Nonpayment of dues	126		
Died	13	214	
		2219	

Members added in 1935		254	
Total annual members in December, 1935		2473	
Life members in December, 1934	54		
Removed in 1935	1		
Total life members in December, 1935		53	
Honorary members in December, 1934	19		
Removed in 1935	1		
Total honorory members in December, 1935		18	
Total members in December, 1935		2544	
Subscribers in December, 1934	1066		
Removed in 1935	104		
	962		
Added in 1935	156		
Total subscribers in December, 1935		1118	
Total members and subscribers in December, 1935			3662
Net gain			90

The net gain for the year is 90, as against a net gain of 151 last year. The growth in membership has resulted from the co-operation given by the many members throughout the country who have sent in nominations. I wish to express my appreciation for this co-operation and bespeak similar aid for the coming year.

We regret to report that during the year we have received notice of the death of the following members, whose names have been removed from the membership list:

O. Fred Boucke
Edwin Cannan (Honorary member)
Harry T. Collings (Life member)
Albert W. Cummins
Felix Flugel
Fred A. Geier
Max J. Kohler
J. Herbert Leighton
Sigurd L. Odegard
William Vipond Pooley
J. E. Sterrett
Frank Hatch Streightoff
Charles Augustus Tuttle
Napoleon Wagner
Philip G. Wright

Respectfully submitted,
F. S. Deibler, *Secretary*

REPORT OF THE MANAGING EDITOR OF THE AMERICAN ECONOMIC REVIEW FOR THE YEAR ENDING DECEMBER, 1935

The expenses during 1935 by principal items were as follows:

Printing (paper, reprints, postage, etc.)	$ 5,087.90
Editorial	2,500.00
Clerical	2,540.00
Supplies	365.70
Contributors	1,357.50
	$11,851.10

The total cost of the *Review*, $11,851.10, was approximately $550.00 more than in 1934 and approximately $200.00 more than the estimated amount in last year's budget statement for this year. This is largely due to the fact that we printed 225 more copies, averaging 4,100, and also 28 more pages in the completed volume.

On the basis of printing the same number of copies per issue in 1936 as during the past year, namely 4,100, the following budget for 1936 is submitted:

Printing (paper, reprints, postage, etc.)	$ 5,100.00
Editorial	2,500.00
Clerical	2,540.00
Supplies	360.00
Contributors	1,500.00
	$12,000.00

The following persons have served as editors during the past year: Professors Carter Goodrich and A. B. Wolfe, whose terms expire this year; Professors R. G. Blakey and H. H. Preston, whose terms expire in 1936; and Professors C. E. Ayres and M. A. Copeland, whose terms expire in 1937. During the year 193 persons have co-operated in writing leading articles, communications, reviews and notes.

The usual tables are appended.

Respectfully submitted,

DAVIS R. DEWEY, *Managing Editor*

TABLE I
PAGES GIVEN TO EACH SECTION*

Year	Leading articles	Reviews	New books listed	Documents, reports, etc.	Periodical abstracts	Notes	Theses	Totals
1920	395	109	155	98	122	42	15	936
1921	331	103	133	39	117	38	11	772
1922	293	91	158	35	124	37	13	752
1923	298	122	184	26	113	43	14	800
1924	339	110	191	23	113	42	18	836
1925	325	131	178	27	110	38	23	832
1926	270	137	184	15	108	43	27	784
1927	262	120	195	32	114	42	27	792
1928	335	111	176	12	121	45	28	828
1929	315	181	173	18	1	52	28	768
1930	348	154	210	12	—	58	29	811
1931	369	170	197	13	—	40	25	814
1932	351	175	203	12	—	27	24	792
1933	360	178	179	6	34	28	24	809
1034	376	120	188	7	48	44	22	805
1935	341	198	183	7	46	37	21	833

* Figures for 1911–19 may be found in the report for 1930, published in the *Supplement*, March, 1931, p. 284.

TABLE II
EXPENDITURES

Year	Printing	Salary of editor	Payments to contributors	Clerical	Supplies	Totals
1920	$6,656.31	$1,500.00	$1,122.75	$1,595.64	$307.20	$11,181.90
1921	5,646.97	1,500.00	64.50	1,472.50	319.97	9,003.94
1922	4,795.28	1,500.00	—	1,370.00	314.77	7,980.05
1923	5,032.59	1,500.00	—	1,650.09	437.86	8,620.54
1924	5,423.28	1,500.00	1,110.25	1,464.01	305.32	9,802.86
1925	5,713.01	1,500.00	1,133.50	1,757.32	406.36	10,510.19
1926	5,332.24	1,500.00	1,128.00	1,589.86	323.43	9,873.53
1927	5,619.20	1,500.00	1,013.75	1,806.50	297.25	10,236.70
1928	5,321.95	1,500.00	1,190.50	1,956.50	375.37	10,344.32
1929	4,927.62	1,500.00	1,328.75	2,004.50	261.72	10,022.59
1930	5,386.67	2,500.00	1,447.75	2,253.00	347.80	11,935.22
1931	5,399.94	2,500.00	1,454.75	2,300.00	327.60	11,982.29
1932	5,143.23	2,500.00	1,451.00	2,300.00	386.13	11,780.36
1933	4,606.07	2,500.00	1,408.25	2,436.00	380.75	11,331.07
1934	4,670.43	2,500.00	1,384.75	2,420.00	326.12	11,301.30
1935	5,087.90	2,500.00	1,357.50	2,540.00	365.70	11,851.10

REPORT OF THE TREASURER OF THE ASSOCIATION FOR THE YEAR ENDING DECEMBER 14, 1935

The report of the Treasurer is developed from the report of the Auditor, with a few explanatory details added.

The total assets of the Association amount to $51,308.44, which represents an increase of $1,425.44 during the year. This total includes cash items of $3,519.19, an investment list, at cost, of $43,394.98, receivables of $735.74, inventories, including unsold copies of *Economic Essays,* paper and cover stock, and stamped envelopes, of $3,394.03, and furniture and fixtures of $264.50.

The total receipts during the year from all sources were $20,476.28, which represents a decline of $379.75. This decrease is explained by a decline of $328.41 in sales, and $72.76 less income from investments. The total expenses for the year amounted to $18,743.51, as against $17,960.02 the previous year, a difference of $783.49. This increase is due mainly to an increase in publication expense. The number of copies of the *Review* printed was larger and there were 16 more pages in the *Proceedings* than in the preceding year.

The net income for the year was $1,396.47, as compared with $3,166.01 for the preceding year. The difference in the operating results for the two years is accounted for mainly by a $606.30 loss on sale of securities, and an increase of publication cost of $762.87.

I want to call the attention of the members of the Association to the care which the Finance Committee has devoted to the investment list. During the ten years that this Committee has supervised the investments of the Association, there has been no loss of interest, and, if the present list had been liquidated at market prices as of December 18, 1935, the proceeds would have been sufficient to cover costs of the list and all losses sustained on sales of securities during the period and still have shown a surplus of $4,590.74. The liquidating value of the list exceeds the cost by $6,993.74. Credit for this excellent showing is due to the care which the Finance Committee has devoted to the interests of the Association.

The Association can continue to operate on the same plane as in the past with its present income. Any substantial expansion of activities would require additional resources.

Respectfully submitted,
F. S. Deibler, *Treasurer*

REPORT OF THE AUDITOR

December 21, 1935

Executive Committee,
American Economic Association, Inc.,
Evanston, Illinois.

GENTLEMEN:

We submit herewith our report on the audit of the American Economic Association, Inc., for the year ending December 14, 1935, together with the following financial statements:

Exhibit	*Number*
Balance sheet—December 14, 1935	I
Statement of income and expenses—Year ending December 14, 1935	II

Results from Operations

For the current year, net income was $1,396.47 as compared with $3,166.01 for the preceding year of 1934, the decrease ($1,769.54) being due principally to a loss on sales of investments and to the increase in publication costs. The following statement presents a comparison of operations for the two years:

Particulars	Year ending December 15, 1934	Year ending December 14, 1935	Increase or *decrease*
Income from—			
Dues	$12,346.80	$12,499.75	$ 152.95
Interest on bonds and time deposits, and dividends on stocks	1,920.43	1,847.67	*72.76*
Profit or *loss* on sales of stocks and bonds	288.40	*606.30*	*894.70*
Other sources	7.93	6.05	*1.88*
Total income	$14,563.56	$13,747.17	$ *816.39*
Expenses and costs—			
Administrative and other operating expenses	$ 5,369.40	$ 5,390.02	$ 20.62
Publication costs	12,590.62	13,353.49	762.87
Publication income	*6,562.47*	*6,392.81*	169.66
Total expenses and costs	$11,397.55	$12,350.70	$ 953.15
Net income or *expense*	$ 3,166.01	$ 1,396.47	$ *1,769.54*

Bonds having a par value of $21,500.00 were liquidated at a net loss of $170.01, and losses totalling $436.29 were incurred on sales of three blocks of common stock.

The number of members and subscribers at December 15, 1934, and at December 14, 1935, was as follows:

Classification	December 1934	December 1935
Members—		
Annual	2,433	2,473
Life	54	53
Honorary	19	18
Subscribers	1,066	1,118
Totals	3,572	3,662

Following is a comparison of publication income and expenses for the years 1934 and 1935, and of the latter with the budget of expenses:

Particulars	Year 1934	Year 1935	Budget for 1935
Income—			
Subscriptions, other than from members	$ 4,994.12	$ 5,242.55	
Sales of copies	725.11	396.70	
Advertising	843.24	753.56	
Total income	$ 6,562.47	$ 6,392.81	
Expenses—			
Printing of—			
Review	$ 4,722.62	$ 5,135.87	$ 4,700.00
Proceedings	1,192.91	1,347.88	—
Editor's honorarium	2,500.00	2,500.00	2,500.00
Paid to contributors	1,384.75	1,357.50	1,500.00
Editorial clerical salaries	2,420.00	2,540.00	2,545.00
Other costs and expenses	370.34	472.24	400.00
Total expenses	$12,590.62	$13,353.49	$11,645.00
Net publication expense	$ 6,028.15	$ 6,960.68	

The cost of $5,135.87 for printing the *Review* in 1935 represented 4,100 copies each of the four issues, aggregating 876 pages, including a twelve page insert in the December issue. The Editor's estimate of *Review* printing costs was based on printing 3,875 copies. Four thousand copies of the *Proceedings* (248 pages) were printed. No handbook was issued in 1935.

Changes in Financial Condition

Following is a comparison of the balance sheets of the Association at December 15, 1934, and at December 14, 1935:

Assets	December 15, 1934	December 14, 1935	Increase or *Decrease*
Cash in bank	$11,097.58	$ 3,519.19	$ *7,578.39*
Investments, at cost, in—			
Bonds	30,989.48	15,280.48	*15,709.00*
Common stocks	3,954.23	28,114.50	24,160.27
Receivables, net	859.01	735.74	*123.27*
Inventories, at cost	2,704.64	3,394.03	689.39
Furniture, fixtures, etc., at cost	1,120.65	1,202.38	81.73
Reserve for depreciation	*841.69*	*937.88*	*96.19*
Total assets	$49,883.90	$51,308.44	$ 1,424.54

Liabilities and Net Worth	December 15, 1934	December 14, 1935	Increase or *Decrease*
Accounts payable	$ 36.48	—	$ *36.48*
Unearned income	2,783.50	$ 3,034.71	251.21
Membership extension fund	3,994.18	3,807.52	*186.66*
Life memberships	4,825.00	4,625.00	*200.00*
Surplus—			
Balance, December 15, 1934	38,244.74	38,244.74	—

Net income for the year ending December 14, 1935	—	$ 1,396.47	$1,396.47
Transfer from life memberships to surplus—1935	—	200.00	200.00
Total liabilities and net worth	$49,883.90	$51,308.44	$1,424.54

Of particular interest is the increase of investments in stocks; the $28,114.50 so invested at December 14, 1935, represented common shares in twelve domestic corporations with the largest investment, $5,887.97, in 100 shares of United States Gypsum Co.

We did not ascertain the market value of securities at December 14, 1935.

The State Bank and Trust Company, Evanston, Illinois, certified to us that it was holding in safe-keeping all the securities owned by the Association.

We appreciate the courtesies shown our representative in the course of the audit.

Very truly yours,

FRANK E. KOHLER AND COMPANY
Certified Public Accountants

EXHIBIT I

American Economic Association, Inc.

Balance Sheet

December 14, 1935

Assets

Current Assets and Investments:			
Cash in State Bank and Trust Company, Evanston, Illinois—			
Checking account	$ 519.19		
Savings account	3,000.00	$ 3,519.19	
Investments, at cost—			
Bonds, par value $16,000.00	$15,280.48		
Common stocks	28,114.50	43,394.98	
Receivables—			
Interest accrued on bonds	$ 201.88		
Membership dues	324.33		
Review advertising	290.00		
Publication sales	31.22		
Subscriptions	66.50		
Sundry	1.81		
Total receivables	$ 915.74		
Less—Reserves for doubtful accounts	180.00	735.74	
Inventories, at cost—			
Economic Essays	$ 1,202.40		
Paper and cover stock	1,915.91		
Stamped envelopes	275.72	3,394.03	$51,043.94
Furniture, Fixtures and Bound Periodicals, at cost		$ 1,202.38	
Less—Reserve for depreciation		937.88	264.50
Total assets			$51,308.44

Liabilities and Net Worth

Unearned Income:			
Membership dues		$ 521.00	
Subscriptions		2,468.71	
Advertising		45.00	$ 3,034.71
Membership Extension Fund			3,807.52
Net Worth:			
Life memberships		$ 4,625.00	
Surplus unappropriated—			
Balance, December 15, 1934	$38,244.74		
Net income for the year ending December 14, 1935 (Exhibit II)	1,396.47		
Transfer from life memberships	200.00	39,841.21	44,466.21
Total liabilities and net worth			$51,308.44

EXHIBIT II

American Economic Association, Inc.

Statement of Income and Expenses, Year Ending December 14, 1935

Particulars		*Amount*		
INCOME FROM:				
Dues—				
Regular members (after deducting $133.75 defaulted dues unpaid at December 14, 1935)			$12,194.75	
Subscribing and contributing members			305.00	$12,499.75
Other sources (net)—				
Income from investments—				
Interest earned on—				
Bonds		$ 1,022.96		
Time deposits		169.01		
Dividends received on stocks		680.70		
Total		$ 1,872.67		
Less—Custodian's fee		25.00	$ 1,847.67	
Net losses on sales of—				
Bonds		$ *170.01*		
Common stock		*436.29*	*606.30*	
Profit on sale of *Economic Essays*			.47	
Royalties on *Economic Essays*			3.20	
Miscellaneous income			2.38	1,247.42
Total income				$13,747.17
EXPENSES:				
Administrative and other operating expenses—				
Secretary's salary		$ 1,000.00		
Office salaries		2,695.92		
Postage		339.38		
Stationery and printing		145.43		
Office supplies		23.88		
Telephone and telegrams		64.21		
Exchange on checks		106.52		
Insurance		79.10		
Depreciation		96.19		
Annual meeting		127.46		
Executive Committee expense		323.46		
Other committee expenses		222.33		
American Council of Learned Societies		65.00		
Auditing		50.00		
Other expenses		51.14	$ 5,390.02	
Publication expenses—				
Printing of—				
Review		$ 5,135.87		
Proceedings		1,347.88		
Editor's honorarium		2,500.00		
Paid to contributors		1,357.50		
Editor's traveling expenses		74.35		
Editorial clerical salaries		2,540.00		
Editorial supplies and expenses		365.70		
Sundry publication expenses		32.19		
Total publication expenses		$13,353.49		
Less—Publication income—				
Subscriptions, other than from members	$5,242.55			
Sales of copies	396.70			
Advertising	753.56	6,392.81	6,960.68	
Total expenses				12,350.70
Net income (Exhibit I)				$ 1,396.47

REPORT OF THE FINANCE COMMITTEE

At the beginning of the year, the resignation of Mr. George B. Roberts from the Finance Committee was received and accepted by the Executive Committee. Mr. Roberts had served from April, 1931, to March 16, 1935, and it was with regret that the other members of the Committee acceded to his request to be relieved of responsibility. Thereupon, the Association was fortunate in securing the services of Charles C. Wells, of Chicago, who has had long experience with institutional investment accounts and is well known to the other members of the Committee.

During the year, the following securities were sold:

Bonds	*Cost*	*Selling Price*	*Profit*	*Loss*
By-Products Coke Corporation	1,020.00	830.83		189.17
City of Cleveland Water	1,039.00	1,025.00		14.00
City of New York Corp. Stock	1,007.50	1,045.00	37.50	
Commonwealth Edison Company	1,895.00	2,091.20	196.20	
Detroit Edison Company	1,042.50	1,097.07	54.57	
Illinois Bell Telephone Company	2,007.50	2,192.15	184.65	
Illinois Central Railroad Company	1,995.00	1,094.17		900.83
Louisville Gas and Electric Company	915.00	1,110.07	195.07	
National Dairy Products Corporation	990.00	1,030.07	40.07	
Ohio Power Company	960.00	1,044.24	84.24	
Pacific Gas and Electric Company	1,970.00	2,101.67	131.67	
Pacific Mills, Ltd.	2,040.00	2,000.00		40.00
United Biscuit Company	983.25	1,035.00	51.75	
U. S. A. (Fourth Liberty Loan)	2,076.20	2,000.00		76.20
U. S. A. Treasury, $2\frac{7}{8}$'s	2,000.00	2,030.00	30.00	
U. S. A. Treasury, $3\frac{1}{8}$'s	1,523.50	1,567.97	44.47	
Stocks				
First National Stores, 20 shares	1,179.30	925.00		254.30
Standard Brands, Inc., 50 shares	800.60	705.63		94.97
Texas Corporation, 50 shares	1,074.75	987.73		87.02
	$26,519.10	$25,912.80	$1,050.19	$1,656.49

A net loss, in relation to cost, of $606.30 was realized.

The following securities were purchased:

Par	*Bonds*	*Cost*
$2,000	Grand Trunk Western Railway Company	$ 1,855.45
2,000	Texas Power and Light Company	2,005.00
2,000	U. S. Treasury, $2\frac{7}{8}$'s	2,000.00
2,000	Wisconsin Power and Light Company	1,895.28
Shares	*Stocks*	
25	Chesapeake and Ohio Railway Company	1,309.07
20	First National Stores	957.48
50	General Electric Company	1,265.97
50	General Electric Company	1,472.22
50	General Motors Corporation	2,057.47
50	Glidden Company	1,459.72
8	Glidden Company	176.00
50	Kroger Grocery and Baking Company	1,297.22
50	Mesta Machine Company	2,007.37
30	J. C. Penny Company	2,121.48
50	Procter and Gamble Company	2,459.72
50	Standard Brands	800.60
50	Texas Corporation	1,074.75
50	Union Carbide and Carbon Corporation	2,867.88
50	United States Gypsum Company	2,747.12
50	United States Gypsum Company	3,140.85
		$34,970.65

The market value of the total investment account on December 18, 1935, was $6,993.74, above cost. The annual interest return from the account now amounts to $2,081.00, which, at present interest and dividend yields, gives a 4.795 per cent return on cost.

It has always been the policy of the Committee to sell any security about which any doubt was entertained, particularly with reference to its future. But in view of business and financial developments, the Committee felt at the beginning of the year that the general investment policy of the Association should be to realize on bonds which were reaching their call level and to establish something like a fifty-fifty balance between equities and bonds. The changes in the investment list noted above were made in conformity with these two policies.

The Finance Committee was created by action of the Executive Committee on April 11, 1925. Two members of the Committee, C. H. Crennan and F. S. Deibler, have served continuously during the ten-year period. Of necessity, holdings have been shifted, and the investment policy has been modified as conditions have changed. Some securities have been sold at a loss, others have shown a profit, but during the whole period there has been no loss of interest and no default of principal.

The loss sustained during the ten-year period on all securities sold below cost was $4,030.99. The profit realized was $1,694.12. The liquidating value of the present list exceeds cost by $6,993.74. Balancing these items, the account would show for the period a net profit of $4,656.87.

The list at market or cost, whichever is lower, stands as follows:

	Bonds	
Par		
1000	Alabama Power Company, 1st Mtg. Lien and Ref.	$ 975.00
1000	Chicago, Rock Island and Pacific Equip. Trust, Ser. "P"	740.00
1000	Crown Williamette Paper Company, 1st S. F.	1,005.75
1000	Erie Rail Road Company, Ref. and Imp.	675.00
2000	Grand Trunk Western Railway Company, 1st Mtg.	1,845.00
1000	North American Edison Company, Deb., Series "C"	965.00
2000	Northern Pacific Railway Company, Ref. and Imp.	1,930.00
1000	Pennsylvania Railroad Company, Gold Debenture	945.00
1000	Southern Illinois and Missouri Bridge Company	750.00
1000	Southern Pacific Railway, 50 yr.	745.00
2000	Texas Power and Light Company, 1st and Ref.	2,005.00
2000	Wisconsin Power and Light Company	1,895.28
	Stocks	
Shares		
25	Chesapeake and Ohio Railway Company	$ 1,256.25
20	First National Stores	915.00
100	General Electric Company	2,738.19
50	General Motors Corporation	2,057.47
58	Glidden Company	1,635.72
50	Kroger Grocery and Baking Company	1,297.22
25	Liggett and Myers Tobacco Company	2,018.13
50	Mesta Machine Company	2,007.37
50	J. C. Penny Company	2,878.28
50	Procter and Gamble Company	2,459.72
50	Union Carbide and Carbon Corporation	2,867.88
100	United States Gypsum Company	5,887.97
		$42,495.23

Respectfully submitted,

C. H. Crennan, *Chairman*
C. C. Wells
F. S. Deibler

REPORT OF THE JOINT CENSUS ADVISORY COMMITTEE

There was only one meeting of the Joint Census Advisory Committee in the year 1935—that held on the 22nd and 23rd of November.

The Committee at this meeting gave consideration to a program of legislation which had been outlined in the Census Bureau and was designed to accomplish the following objectives: (1) codify the legislation which has been enacted since the permanent Census Act of 1902, and provide the legal basis for a unified program of statistical inquiries; (2) co-ordinate the work of the Bureau to the end that related inquiries are conducted at the same time, or for identical periods; (3) provide an increasing amount of data on a quinquennial and on an annual basis, particularly with regard to the activities of trade and industry; and (4) reduce the severely fluctuating work load now imposed upon the Bureau.

Under this plan the main census inquiries would be covered by comprehensive quinquennial censuses supplemented by annual compilations of more limited scope in intervening years, as indicated by the following resolution which the Committee adopted:

Resolved, That the Committee favors a quinquennial census covering population, agriculture, and such other related subjects as it may be desirable to include, scheduled for the years ending in "0" and "5"; also a quinquennial census of manufactures, mines and quarries, power units, communication, transportation agencies, trade, and services for the years ending in "2" and "7"; also the plan of making such annual compilations as will preserve the continuity of the data obtained in the quinquennial censuses and administer to the needs of other governmental and private agencies by the more frequent reporting of some of the basic data.

Another item on the agenda of the meeting concerned the question of what the Bureau should do about making estimates of population now that the plan for a quinquennial census in 1935 has been rejected and the method of estimating heretofore followed by the Bureau has proven to be inapplicable to existing conditions. This same question was debated in a conference held last September in which representatives of the Population Association of America, the Special Advisory Committee on Vital Statistics and certain officials of the Census Bureau participated. The resolutions adopted at the meeting of the Joint Advisory Committee on the Census follow very closely the recommendations of that conference.

Resolved, That the Committee recommend:

1. That in so far as available information will permit satisfactory estimates:
(a) The Bureau of the Census continue to accept the responsibility for making population estimates;
(b) Estimates be made for cities having 10,000 or more inhabitants at the 1930 census;
(c) Estimates be made for counties or for groups of counties;
(d) Estimates be made for the rural population of states and for the population of cities of 2,500 to 10,000 in each state as a group.

2. That in making these estimates, the Bureau of the Census avail itself of all useful material, whether supplied by its own records or derived from other sources.

3. That the methods for constructing the estimates shall be determined by the Bureau of the Census; and that in publishing estimates the Bureau describe the method or methods which have been employed, and indicate the reliability to be expected.

4. That the Bureau of the Census be provided with adequate facilities for making short-term population estimates.

In another resolution the Committee expressed the opinion that the Bureau would not be justified in publishing any more death or birth rates until satisfactory estimates of population are available.

The Committee was disappointed to find that the Bureau's difficulty in obtaining adequate funds for printing its reports, which has been the subject of resolutions adopted at previous meetings, still continues. Of the allotment for the current year nearly one-half had to be used for printing reports which for lack of funds were carried over from the preceding year. The remainder is now practically exhausted, leaving nothing for the reports now ready or to be completed before the end of the fiscal year. In view of this situation the Committee felt compelled to bring this matter again to the attention of the Secretary of Commerce and the Associations which the Committee represents by adopting the following resolutions:

WHEREAS, The Committee has previously expressed its concern over the fact that the funds allotted to the Census Bureau in recent years for printing its reports have regularly been much below the amount requested and found necessary for that purpose; and

WHEREAS, Notwithstanding the fact that the Secretary of Commerce succeeded in 1934 in obtaining additional funds sufficient to print the delayed reports that had accumulated up to that time, the Committee finds that the situation has not improved, but rather has become worse; that nearly one-half of the allotment for the current year had to be applied to the printing of reports that had been carried over from the preceding year because of the exhaustion of the funds for that year; that the allotment for the current year is now nearly exhausted; and that for the printing of the reports which will be completed before July 1, 1936, the Bureau needs something like $40,000 which is not available; be it

Resolved, That the Committee, to its regret, finds itself again compelled to deplore a condition under which, as here illustrated, valuable and costly statistical surveys required or authorized by law are undertaken and conducted without any assurance or certainty that adequate funds for printing the statistics will ever be provided, and that the Committee can but condemn the waste and improvidence displayed by the government in appropriating money for compiling statistics without making adequate provision for publishing the results of such compilations. Either the Bureau should be provided with funds sufficient to print the results of the statistical compilations which it is authorized or directed by law to make, or else the scope of such compilations should be reduced to come within the limits imposed by the funds that will be available for printing the results.

The Committee followed this by a resolution "inviting the attention of the Census Bureau and those responsible for the appropriation or allocation of funds for printing to the possibility of using new processes of reproduction which are more economical than the usual method of printing from type." The Committee had in mind especially the process of "offset printing," and informally approved the use of that process for printing the 1934 Mortality Report already complete in manuscript. The Bureau, in fact, may find it necessary or advisable to use the same process for all the reports that are now ready for publication or will be ready before next July. The list includes the 1933 biennial report on manufactures, the 1933 and 1934 reports on criminal judicial statistics, the 1934 reports on births, financial statistics of cities, prisoners, mental patients, and mental defectives, and the 1935 report on vegetable fats and oils—a total of about 2,000 pages.

The Bureau of the Census has for many years published a *Weekly Health Index* giving deaths and death rates for the principal cities of the country, the data being supplied by telegraphic reports sent from the city health offices. The question has been raised whether a publication of this kind does not more

properly belong in the Public Health Service and overlap or duplicate in some degree the published reports of that Service. It was explained to the Committee that this question had been taken up with a Public Health Service official, and the suggestion made that the publication by the Census Bureau be changed to a monthly, leaving to the Public Health Service the compilation of weekly data. Without expressing any opinion as to what should take its place, the Committee passed a resolution recommending discontinuance of the weekly publication.

EDMUND E. DAY, *Chairman*
GEORGE E. BARNETT
LEO WOLMAN

REPORT OF ACTIVITIES OF THE SOCIAL SCIENCE RESEARCH COUNCIL 1934-35

The specific interest of the Social Science Research Council is in research leading to new knowledge and understanding of man's life in the midst of a multitude of human relationships and institutions. Around this essential interest lie related and secondary interests with which the Council may regularly or occasionally concern itself. Thus aside from direct research, the Council has regularly sought to perfect the instrumentalities of research through improvement of workers and materials and methods. So also it has on occasion undertaken to render immediate public service by assembling at the disposition of public officials existing resources of knowledge and of men for the solution of technical problems; and on broader problems of policy and action, to initiate inquiries intended to bring to bear not only the results of research but all other knowledge and wisdom and opinion that may be available.

With respect to any enterprise which requires financing, the Council is of course limited by its ability to raise funds. It has become evident that in order to raise general trust or endowment funds to be expended in its own discretion, it is essential that the Council should itself participate in the selection of its members. For that reason, a proposal was laid before the Council at its last meeting for nomination by the Council after consultation with the proper authorities of the constituent societies of panels of nominees for election by their respective societies to membership in the Council.

The Council has been fortunate in the matter of special funds for fellowships.

During the past year the Committee on Social Science Personnel awarded the eleventh annual series of post-doctoral research training fellowships and two new series of fellowships, the pre-doctoral field fellowships and the pre-doctoral fellowships for graduate study. Appropriations for stipends and allowances totaled approximately $102,000.

Post-doctoral awards, with which all members of the Association are familiar, included twelve new appointments for periods of one year each, one new appointment for a period of two years, and two reappointments for a full year, a total of fifteen appointments.

Twenty-six pre-doctoral field fellowship awards were made for periods in 1935-36 varying from nine to twelve months. These fellowships, initiated for the purpose of increasing opportunity for experimental training to supplement more formal graduate study, were open to candidates not over twenty-seven years of age who completed all requirements for the Ph.D. except the thesis and examinations dependent upon it not later than July 1, 1935. The response to this new type of award by graduate students and university faculties, as well as the generally high qualifications of the candidates and their proposed programs, has convinced the Council's committee of the great utility of these fellowships in a program for the development of research personnel in the social sciences. This new type of aid is one of the greatest importance. In the interest of research training and of strengthening personnel engaged in teaching the social sciences, it is our hope that the number of such fellowships can be substantially increased.

Pre-doctoral fellowships for graduate study, awarded for the first time during the past year, include eight appointments from a total of eighty-six applicants, only seventy of whom completed the examinations required of all candidates at this level. They were open to persons not over twenty-five years of age who held or expected to receive the bachelor's degree not later than July 1, 1935, and had not completed more than the equivalent of one semester's graduate study before the same date. The members of the Association will be interested in the report of the examining committee and the examinations given. They have been published by the Council as Bulletin No. 23, under the title, "Examining Fellowship Applicants: A Report Made to the Social Science Research Council on the Method of Selecting Fellows for First-Year Graduate Study," by Carl C. Brigham. In the opinion of your representative on the Council, this report presents in a splendid way the present unsatisfactory preparation for graduate work in the social sciences.

The Committee on Grants-in-Aid made fifty awards totaling $23,675 for work during the academic year 1935-36. As in previous years, these awards were for the purpose of aiding mature scholars in the completion of research projects already well under way. The sum of $25,000 which will become available on April 1, 1936, for grants-in-aid of research to be carried on during 1936-37 terminates the four-year appropriation to the Council for this purpose. If these awards are to be continued without interruption, new funds must be secured before the summer of 1936. The Council has repeatedly shown itself more attached to grants-in-aid than almost any other item of its program, but it faces great difficulty in securing funds for this purpose.

Standing committees have steadily pursued their objectives. Experimental efforts have been initiated to see whether the Council can play a useful rôle in these areas of research for which it is unable to secure any financing. The major research projects of the year have been in the field of population distribution, an enterprise conducted by the Wharton School of the University of Pennsylvania, and in the field of credit and banking in relation to economic stability, a study of real estate financing which is being conducted by the National Bureau of Economic Research. Two major undertakings culminated during the year in the reports of the Commission on National Policy in International Economic Relations and of the Commission on Public Service Personnel.

H. A. Millis
Alvin H. Hansen
Sumner H. Slichter

REPORT

of the

DINNER MEETING IN CELEBRATION

of the

FIFTIETH ANNIVERSARY OF THE FOUNDING

of the

AMERICAN ECONOMIC ASSOCIATION

THE FIRST MEETING

SEPTEMBER 8, 1885

According to the report of the Secretary of the Association (*Publications of the American Economic Association*, Vol. I, No. 1), the following persons were present at the meeting called for the purpose of organizing an economic association:

Hon. Andrew D. White
President C. K. Adams
Professor H. C. Adams
Professor R. T. Ely
Professor E. J. James
Rev. Washington Gladden
Professor E. Benjamin Andrews
Rev. Samuel W. Dike
Professor J. B. Clark
Mr. V. B. Denslow
Hon. Eugene Schuyler
Professor Alexander Johnston
Dr. E. R. A. Seligman
Professor H. B. Adams
Mr. F. B. Sanborn
Miss Katharine Coman
Professor Davis R. Dewey
Dr. Edward W. Bemis
Mr. John A. Porter
Dr. Clarence Bowen
Professor Herbert Tuttle

THE FIFTIETH ANNIVERSARY

1885-1935

The American Economic Association held its first meeting at Saratoga, New York, on September 8, 1885. The special session of the present annual meeting that was devoted to the celebration of that historic event was a dinner meeting, held at eight-thirty o'clock on Saturday evening, December 28, 1935, at the Hotel New Yorker, New York City.

The Chairman and Toastmaster of this occasion was Professor Frank A. Fetter, of Princeton University.

CHAIRMAN FETTER: Hear ye, hear ye! Friends and colleagues all. In my present position I can fully appreciate the emotions of the Light Brigade. Big guns to the right of me, big guns to the left of me, big guns in front of me. They have not yet volleyed and thundered, but some of them soon will. I hesitate, in the face of this distinguished company, to go on with my mid-Victorian poetic lore to say, "Into the valley of death rode the six hundred." Then, too, I look with a sense of guilt at Wesley Mitchell, for he at once detects in my figures a mathematical error of five hundred ninety-nine; so I hasten to shift my remarks to sociological grounds, where no accuracy is necessary.

This is a historic occasion, the fiftieth anniversary, the "Golden Wedding," of the American Economic Association. It goes to show the courage of American economists that they have dared to have anything to do at this time with gold. Two years earlier we might have had a 100 per cent anniversary, but at the present time it is 41 per cent devaluated, and we hasten to have our golden dinner before it sinks to zero. But no matter what the gold basis, this anniversary dinner will be 100 per cent in spirit. Gold may become worth nothing, but we are not disturbed for we are sure that whatever the depreciation, our loyal former president, Irving Fisher, will always be able to make the proper compensation.

Fifty years ago, a little group of venturesome social students organized this Association, and destiny has given it to some to live to decorate this occasion here, to our great joy. The formation of the American Economic Association was a historical event; it was a great step in the development of American institutions. Therefore, it has the approval of institutional economists and statisticians as well as of the historians, and all that remains is to win the approval of the corporal's guard, still surviving, of real economists.

We have here, as guests of honor on this occasion, not only four of the charter members of this Association, but also a number of those who joined within the first ten years of this society's existence. In this period of financial uncertainty, we can assure our younger colleagues that this is one sure bet. All they have to do is join this Association, maintain their membership for fifty years, and when they attend the one-hundredth anniversary, they will get 1000 per cent on their investment.

The little group that planned this Association and met in September of 1885 at Saratoga was in many ways remarkable. One of the oldest of the group was Andrew Dickson White, president of Cornell University and later ambassador to Russia and to Germany. Of this number was, also, a young, ambitious professor

of political economy, destined to become the President of the United States and the progenitor of the League of Nations, Woodrow Wilson. Then, too, among the others were four who, after a half-century of distinguished and useful work, sit here at this table tonight—John Bates Clark, E. R. A. Seligman, Richard T. Ely, and Davis R. Dewey.

While attending some of the sessions of this meeting, I have gathered from the remarks of some of the speakers that laissez faire is dead. It is a very interesting and startling piece of information, because as you read the discussions of the founders of this society at the first meeting fifty years ago, you discover that they, also, thought laissez faire was dead. Nine years later, at the first meeting of this Association that I attended here, at Columbia University, in December, 1894, a young man from the Middle West had, at a considerable sacrifice to himself, come on to read a paper to demonstrate the proposition that laissez faire was dead. His great disappointment was that it didn't create a riot in the meeting, at which Professors Clark, Seligman, and Patten were present, and he fell to quarreling with us because we wouldn't quarrel with him. Everybody said, "Of course it is dead, and it has been buried for a number of years. So what? Why disinter it?" But at every meeting since that time, someone has informed us with scare headlines that laissez faire was dead. And now, within the last two years we have been reinformed, or reformed, again and again by philosophers in Washington that laissez faire was dead. I submit that this is a noble work for this Association to have accomplished in fifty years!

During the nineteenth century our chosen discipline was known as the dismal science, but the organization of this Association was meant to change that adjective "dismal" to something rosier and more cheerful. I hate to be a crape hanger, but I fear, on the face of the record, that all we can now claim is that economics has merely been changed from a dismal to a mournful science. For fifty years we have been attending the obsequies of that most persistent concept, laissez faire, with more than the proverbial nine lives of the cat. It has been a prolonged wake. *Requiescat in pace!*

At that first meeting one of the oldest of that group of young men was Dr. John Bates Clark. He already carried on his shoulders the weight of thirty-eight years. Since then he has lived a half-century more, and he is here tonight to bless us with his presence. Modest, patient, judicious, kindly, the inspiration that he has given us through his teaching and writing is but a part of the helpful influence emanating from him during the past half-hundred years.

We have assured him that he is not expected to make a speech but that his very presence here is more than a brilliant oration. The fact that he is here to bless us is sufficient, and we wish him merely to stand and speak a word, if it is in his heart to do so. Professor John Bates Clark! [The audience rose and gave Professor Clark a great ovation, thus expressing their respect and affection for this venerable man and scholar.]

JOHN BATES CLARK: Mr. Chairman, Ladies, and Gentlemen: I wish I had a speech worthy of such a reception as has been given to me, personally. All that I can say will have to be in the way of certain important facts which are in the line of work which I have to do every day. The old world in which we are living

has a goodly number of virtues as well as things that are not virtues, but the thing that is most virtuous in any connection with the world is the tendency to give to everyone what he gives to society.

That looks like a statement that is very much better than can truthfully be made about this old world. Offhand, the impression would be that every day and every night we are bestowing wealth on persons that didn't have ordinary right to it, except that the laws of the land happen to have been made in such form that they are able to get it.

I generally try, in the courses of lectures that it falls on me to give, to make reasonably clear the fact that the basic laws of society are honest. The general tendency is to give a man what he creates. He doesn't get it all, perhaps; several men there are who do not get it all, and there are a number of men who get more than all, but that is not a description of any society that we live in. It is not a basic fact in any economic city or state. And the duty of every citizen and the privilege of every large body of citizens is to remove from the action of society the tendency to distribute wealth in that way—the tendency to give people more than they create and have them take it out of what somebody else created. Society is full of lesser effects of that kind. If I had a class before me here, instead of a large audience, I would find it necessary to try to prove the tendency of society towards honesty.

Honesty is something more than the best policy. Honesty is something that is indispensable in ordinary business. The tendency is to make wages and salaries conform to what the man is worth, and what the man is worth is determined by his purpose in society, and the amount by which he increases the wealth created.

We live in a basically honest society. Now that is what I have to say every day, and therefore you will not need to come to any of my lectures because that is the substance of the reasoning from fact and economic law, that tends to prove the general tendency of the society we live in, to give men what they create.

Well, that is a solemn expression, and I don't know that it exactly fits an address just after dinner, but after dinner is a very good time to think of it, and I leave that one proposition and stop with that one proposition, which is the inherent honesty of the laws of society.

I trust there is no doubt whatsoever that we belong to a body of people whose action tends to adhere supremely to that law of honesty to which every society like ours is subject. That is a splendid subject for after dinner, and so I will stop here.

CHAIRMAN FETTER: Among those present at that historic meeting at Saratoga was one, youngest in years, but not the least in learning. This is a company of friends and not a public audience, and if a personal reference may be harmless, I will say that a certain ornamental beard has been the envy, the emulation, but the despair of all of the rest of us. There was some question as to why that disguise, and I have now to reveal to you the real explanation. Its owner was so young and yet so learned that no one would believe or trust his learning unless he put on the mask of the patriarch. And so, when I first knew him, before there was any *Who's Who* with its revealing chaos of facts and dates responsible for all sorts of domestic calamities, I supposed he was indeed my grave and reverend

senior. For years, deceived by his false appearance and his false—no, his genuine—beard, I did him the reverence due from youth to age. At last, I discovered that he was barely twenty-four months older than I was, and I came to enjoy, as have many of you, his warm friendship. From that day he has been Edwin to me, and I Frank, to him.

So I take great joy in introducing to you our very dear friend who, years ago, earned rightly the title of New York's most valuable citizen. Professor E. R. A. Seligman!

EDWIN R. A. SELIGMAN: Mr. Toastmaster, Colleagues and Old Boys and Girls whom I see before me: I had expected to speak to you tonight at some length about those distinguished members of the Association, no longer with us, who played an important rôle during the first decade of our existence and whose names we all cherish and honor. The obdurate physician, however, has laid down a limit of just two minutes for my postprandial speech and that is not an easy task to accomplish. I had intended to say something to you first of our earliest President, General Walker, that handsome and uniformly affable grand seigneur who gave us all courage and inspired us with enthusiasm in those early days.

I had expected to speak to you of my dear friend Henry C. Adams, that profound and learned student who was in doubt as to whether to devote himself to his old religion or to the new religion of economics, until, finally, after having suffered earlier reverses at his college in the center of New York, he came to me one day and asked, "Is there no topic in economics to which I can devote myself and about which no one will get excited?"

I said to him, "Public debts." And that was the beginning of his career in public finance.

I had expected to speak to you at some length of Simon Nelson Patten, that blunt but tender-hearted man, generous in his appreciation of his fellow members, who used to keep us all agog with the proof that the pig was the cleanest of all animals.

I had expected to discuss Arthur T. Hadley, that brilliant but paradoxical mind who did so much for us in those early years in applying to our own problems the teachings of Gustav Cohn on railways and of Adolf Wagner on private property.

I had expected to speak to you of Edmund J. James, whom we are wont to forget, today, but who, as a practical and farsighted scholar, was perhaps the first to sound the note of doubt as to the relation of the government to municipal enterprises.

I had expected to say a word or two about Franklin H. Giddings, that clear thinking and philosophical mind whom I helped to abandon journalism for science about who soon deserted us for the wider and vaguer regions of sociology.

I had expected, finally, to speak to you of my dear colleague, Richmond Mayo-Smith, some of whose students I see before me today, that calm and judicious scholar whose deserts, I think, have never been adequately realized, because the *magnum opus* on which he had been at work for so many years was unfortunately never published, due to his untimely death.

But in addition to those men, all of whose names are household words to us

today, I had also expected to speak to you more at length of a little-known episode in the early history of economics; namely, the Political Economy Club which was formed here in New York a short time before our Association, and which owed its existence primarily to J. Laurence Laughlin, who soon became the head of the department of economics at Chicago. That club, which lasted only as long as he remained in New York, five years or so, was a worthy replica of the first society of that name in London and included a notable representation of the local economists, financiers, statesmen, and editors of the old school.

Among the half-dozen men whom I had picked out as worthy of characterization was David A. Wells, that master collector of facts, that keen observer, that staunch upholder of the old régime, and who once told me that he could recognize a socialist or a bimetalist at once by the very glint in his eye.

I had expected to speak to you of Horace White, that kindly man, always generous to the efforts of his young colleagues, that successful and popular expositor of sound monetary law.

I had expected to say something of Edward Atkinson, who was perhaps the earliest exponent of economic science among the business men, who stressed the economy of high wages, and whose famous Aladdin's Stove gave us many a delightful meal at his house.

Finally, I had expected to speak to you of those two doughty journalists, Charles A. Dana, the editor of *The Sun,* who had now forgotten his earlier experiences at Brook Farm, and "Larry" Godkin, the editor of *The Post,* a twain of whom it was said, you remember, that the one made vice attractive in the morning, and the other made virtue repulsive in the evening.

All of these it had been my intention to discuss at some length. But, as I see from the watch that my doctor's admonition must be followed, I can only say to you how happy a day this is for me to be with you all again and to bespeak for the Association during the next half-century a success even more pronounced and more resplendent than the one that has been achieved.

Chairman Fetter: When I first entered economics with a hesitating step in the early nineties, another of those grave and reverend seniors, to me, was likewise, I discovered later, my senior by only a few years. Precocious in his economic training, he was writing monographs in his early twenties, upon which he built firmly a national and international reputation for scholarship in the field of the tariff. This man whom I can no longer, with all the arts of the Toastmaster, conceal from you—his identity is already betrayed—has also had an exceptional career as a teacher and a scholar. And, while I do not wish to start a commotion here, to have this friendly meeting break up in a fistfight, I am inclined to nominate him as that teacher who has perhaps had more of the younger American economists under his instruction and influence than anyone else here. I know that some of the loyal students of other teachers—of Ely, of Commons, of Seligman, of Clark, even of myself—may be moved to protest, but I suspect that we are all pikers compared with Professor Taussig in this respect. Not only is his authorship and leadership in the field of economics distinguished, but one of the greatest services he has rendered, which may be less conspicuous, is the kindly guidance he has given as the editor of the *Quarterly Journal of Economics* to

countless numbers of American students. Under his grave exterior he hides a kindly heart, which made the wastebasket as nearly useless as possible in a well-conducted editorial office. And I know from my own knowledge, incidents which he has probably forgotten, of young men who sent him manuscripts, faulty and imperfectly written, who would receive them back after painstaking reading, with words of encouragement, guidance, and suggestion, which enabled them to salvage at least a part of their work and to contribute something worthy to American economic scholarship. We hail Professor Taussig as an economist, a scholar, and a man. Professor Taussig!

F. W. Taussig: Mr. Chairman and Members of the Association: It has often been noted as a characteristic of the modern world that it is subject to rapid changes, to waves of fashion; and this seems to be the case in the United States more than in any other country. We economists are not immune. As our President noted in his masterly address last night, we have had during the life of this Association, in succession, first, the revolt against laissez faire by the historical and realistic school; then, the Austrian school; then, the neo-classic school of Clark and Marshall; and now we have the institutionalists, while side by side with these comes the youngest and lustiest group, that of the econometricians and the mathematicians. Nowadays, one or the other of these last attracts the young, the able, the ambitious, the promising. As we look back on the earlier schools and their protagonists, and see them as from a distance, we cannot but wonder what the scholars of the coming generation may say when in their turn they survey and adjudge what is now modern and will have become history for them.

Let us look for a moment at the present. The two groups—on the one hand the institutionalists and their kin; on the other hand the mathematicians and the econometricians and the imperfect competitors—hold the stage between them. The institutionalists came earlier in time and perhaps have lost some of their momentum; the mathematicians are younger and as yet apparently are beset by few of the doubts or reservations that come with maturity. The former are the intellectual heirs of the historical school; the latter, of the Ricardians. They look askance at each other, much as their predecessors did half a century ago. The institutionalists say, or inwardly feel, that the mathematicians, and the econometricians, too, are far from life and its facts, deal with assumed or inexact quantities as if life were all a matter of mathematics, wrangle about supposed cases that have no counterpart in the real world, toy with intellectual playthings, and deceive themselves into believing that thereby they are making great economic discoveries. They remind the institutionalists of the remark which one great mathematician has made about his own work and that of his fellows: it is the privilege of all mathematicians to know nothing of the subject they are talking about. The mathematicians on their part look down on the institutionalists as discoverers of the obvious, quite hazy as to what they mean by an institution, lacking in the objectiveness of science, disposed to believe that to be true which they wish were true, incapable of severe reasoning, and unwilling to face unwelcome facts. Underneath these divergences and recriminations there often lies a difference of attitude toward social change and social reform. The mathematicians on the whole are disposed to conservatism; the others, to what is col-

loquially called bolshevism. I say that there is this difference of attitude on the whole. When one thinks of Walras and Pareto, or even of Jevons and Marshall, or of one among our distinguished presidents—Irving Fisher—it is clear that common ground as to economic methodology does not always lead to the identity of attitude on matters of social policy. Yet, in general, some such difference of tinge seems observable. The institutionalists call the mathematicians exact but hard-boiled; the mathematicians call the institutionalists well meaning but soft-headed.

A cleavage is not to be denied in methods, in scope, in social attitude. Does it necessarily lead to two separate camps, one of which would sweep the other out of the way and take its place? Rather, should there not be an accepted division of labor in which each sticks to his last, and both work side by side for common ends?

There are distinctions in economic methodology which are familiar to all of us. Most familiar in our doctrinal history is that between what is and that which ought to be—the good old controversy as to whether economics as such should pay attention at all to that which ought to be. Somewhat more recent, and more deserving of attention just now, is the distinction between the social and economic structure as it stands now and the course of past development by which it has become what it is, and of the future development into something which will infalliby be very different as the ages slip away. Most of us would agree that the core of the economists' work, certainly the thing that most calls for attention in his work and teaching, is the economic structure as it is. Whether we should go beyond this and be advisers and reformers, too; whether we should be practitioners as well as biologists; whether it is part of our business to keep within the scope of our science to enter on the teleological path, depends on just how we define our "business" and what we adjudge to be "science." And whether we should be sociologists as well as economists is, after all, a matter of individual bent and ambition. I am not particularly interested in any debate on what is and what is not "scientific." It seems to me a simple matter of terminology. One thing is clear. We are giving advice all the time. When we refrain, we do so only because we are not quite sure just what advice is good. And when it comes to science in the supposedly stricter sense in which the word is often used, it is not to be doubted that the institutionalists face and discuss a great problem which quite belongs in that upper sphere. The course of social and economic development—what it has been, what it is, what is to be the outcome—all this calls not only for exacting historical and analytical labor, but for objective, cool-headed, dispassionate treatment, quite as much as does the analysis of the existing status. If something of the subjective element inevitably enters in, the same is true about any and all of man's thinking. Even the mathematicians and econometricians are men of flesh and blood. They emerge from behind the mathematical screen and do not hesitate—as mere men—to let it be known how they feel. The important thing is that any one who gives advice or plans policies should bear in mind just what he is doing—how far analyzing the given situation, how far sitting in judgment on it; how far trying to find out what it is like, how far trying to find the best ways of dealing with it.

The main business of a body of scientific men such as are gathered here is

the first—that of finding out what the economic structure is like. On that we need aid from every side and from all sorts of intellectual inquiry—from mathematics and statistics as well as from history, psychology, ethics, and the whole round of what we embrace under the social sciences. As times and needs change, as the intellectual movement turns in one direction or another, new conditions have to be faced, and leaders appear who blaze new paths. Each generation goes ahead in its own way, and each contributes to the sum of our understanding and our equipment.

I do not look on the debates and contentions of the time with regret or apprehension. They are the marks of progress. I am quite satisfied that the older generation should take the back seats. I am quite satisfied, too, that there are differences and some impatience with each other among those of the new generation. When men of science meet in conclaves of their own, they always dispute. Some times they express themselves roundly and even satirically about each other's theories and notions. The unlearned think these amenities indicate that nothing is settled, all is open, and no one is entitled to speak with authority on any topic. The explanation of the turbulence which puzzles the public is simple. When men who are proficient get together, they talk not about the things which are old and familiar but about those which are in the stage of novelty and uncertainty. It would be a bore to talk about that on which all are agreed. The unsolved problems and the tentative solutions are what interest us.

I would not pretend that the body of established knowledge which is thus ignored in scientific meetings is as large or as well knit in our subject as in many another. Yet, there is enough. I suppose, for example, that in this room not one of our professional economists would have a good word to say of the present silver purchases by the United States government. We don't need to discuss that among ourselves; we are all agreed. Again, when the newspapers talk of an increase in our exports as if it were a source and a measure of growing welfare, we don't bother to explain every time what it really means and what is the nature of the gain from international trade. Needless to say, there are problems of international trade and monetary problems about which we are not at all agreed, chiefly because they are of a new kind. Take the present monetary position of our country, our queer standard, if it is a standard. The piece of paper is still a promise to pay one dollar on demand. Apparently it is just that piece of paper. We have something *like* a gold standard, but one cannot get any gold. It can be got for some purposes of foreign trade, of course; but how is that availability going to impinge on prices? It is an interesting problem how, under a semigold standard of this kind, the monetary system is going to work; and it is only a political guess how it is going to be managed. We talk much about such matters as these because they are new, perplexing, important, and, not least, pique our intellectual curiosity. It does not follow that we are never in agreement on anything at all.

But there is another aspect to this. Our debates and disagreements mean progress. They mean that we are moving forward. There are some countries in which thought upon social and political subjects has come to be fossilized; there is an orthodoxy; no heterodoxy is permitted. Fortunately, among us there are a

great many problems on which there is no orthodoxy or heterodoxy; they are just problems. Ours is a young and imperfect science. A great field of the unknown lies before us. For that reason it is the more fascinating. None the less there are plenty of things we know and understand so well that they belong in the textbooks; not in the gatherings and publications meant for the profession. Therefore, to repeat, we should be glad that we differ, not sorry. Differences mean that we are alive and vigorous—that the march of intellectual progress goes on. We help each other by debating with each other.

There is a story told of the elder Rockefeller. If it is not true, it is well invented. It is to the effect that at a meeting, years ago, the directors of one of the companies had a report that had been brought in about a new oil find. It was very large in quantity but very dirty, very black, and of unusual chemical composition, not workable by the standard technological methods of those days, and involving great risks. Some of Rockefeller's associates were disposed to say, "We'll have nothing to do with it." But the old gentleman said, "Let's stick to it, gentlemen; it is all good grease."

As I look about me, sometimes I see turbidness, perhaps, and sometimes I see men going ahead with an apparatus of a kind I do not understand and can't manage, and I wonder what they are going to make of it. But I see there is a great deal of stir; they are spry, active, and intelligent people; and I, too, say, "Well, it is all good grease."

CHAIRMAN FETTER: I think we must all echo the sentiment of Professor Taussig, from our own experiences, that we emphasize our differences. Now there have even been times when the Professor and I did not agree.

DR. TAUSSIG: No, we didn't agree, thank God!

CHAIRMAN FETTER: But when it came to the working out of conclusions on certain practical questions, with tears in my eyes I watched this misguided man going down one road, and I went another way. Then, after years had passed, I would find myself wondering where he was, what had become of him, and I looked up and found he had arrived there before I had. We traveled different roads, but somehow we arrived at the same conclusions on the things that count most.

I bring you a word of cheer. There is a recent improvement in technology that is likely to help economists to better agreement. In this modernly equipped hotel has been installed a loud speaker at the back of the hall, and I have discovered its great usefulness. The program at this meeting was impartially balanced by the Committee, so that spokesmen of varied philosophies might be heard. Sitting in front I would listen to one of the speakers and say, "That is a good, sensible speech." Then some other man would get up, who seemed to me to be talking nonsense; but when I listened to him from the back of the room and got everything he said in reverse, I found that it began to make sense. So now, I have an infallible recipe to make our future meetings harmonious. It is just a matter of which ear you are going to listen through.

At that historic meeting which we here celebrate there was another young man just a little older than Professor Seligman, and he is here tonight. For fifty years, he has hardly missed a meeting. We are all familiar with the sight

of his heroic figure and his leonine head. In the capacity of teacher, his reputation is national. He produced the standard work on financial history. In 1910 he entered on a new phase of his career as editor of the *American Economic Review*, and in the past quarter century has been the one unchanging economic factor in a changing world.

Of his editorial services, I feel like plagiarizing what I said of Professor Taussig. To the constructive criticism of these veteran editors the American economists owe a debt of gratitude. Many a time at these meetings some young man has pointed to a tall form in gray homespun and asked, "Is that Professor Dewey; is he the man who invented Simplified Spelling?" My answer has been, "No, that is the man who, when you sent him your imperfect manuscripts, corrected your complicated spelling." And so, I introduce to you your friend, and mine, Professor Davis R. Dewey!

DAVIS R. DEWEY: Mr. Toastmaster, Members and Friends of the American Economic Association; and to John Bates Clark, my most affectionate salutations: Although I was an humble camp follower at the founding of our Association, I shall not attempt to add anything to the narrative of its youth.

My theme rather relates to the latter half of its fifty years of life, and my jusification for this is because the latter period coincides with the existence of the *American Economic Review,* which you authorized twenty-five years ago. I should be ungrateful if I did not recognize the confidence you have shown in my stewardship, and my gratitude is indeed great.

By this time I ought to be educated in economics. I have read 22,000 printed pages three times, once in manuscript, then in galley proof, and finally in page proof. In addition to the twenty-five bulky volumes, I have read hundreds of manuscripts which, for one reason or another, were denied publication. I do not, however, claim to be the *best* educated economist in the United States; I yield the palm to Professor Taussig, whose experience as editor extends over a longer period.

DR. TAUSSIG: Again, a purely quantitative comparison.

DR. DEWEY: The reading of manuscripts and proof may appear to you as somewhat dull exercise, and yet it has its thrills. Twice your *Review* has been threatened with libel suits, entailing long weeks of pacifying correspondence. Threatened libel suits, however, are rare, but there are other thrills. There is the reconciliation of opposing opinions of associate editors as to the merits of submitted manuscripts. The associate editorship is no honorary position.

Whatever success the *Review* may have had is largely due to the associate editors. Specialists in different fields of economics, their comments on submitted articles are most illuminating and provide a protective rampart behind which the editorial office can safely hide. During this twenty-five years, forty-six different associate editors have aided in the management of the *Review*.

But what is the managing editor to do when one of his associates condemns a manuscript and another approves? Well, the managing editor takes no chances, and the writer is courteously informed that owing to pressure on our space we are unable to accept his manuscript at the present time.

This form of refusal, however, is not based on a fiction. So great is the interest in economics, compared with twenty years ago, that a quarterly is no longer

adequate for the publication of all the worthy articles submitted. There must be a selective discrimination which doubtless is tainted with error.

If interest in economics continues to expand at the rate noticeable in the last ten or fifteen years, the Association must face the problem of enlarging its publications in order to be truly representative of economic thought. During the past few years, several new economic journals have been established, and there are more in the offing. The establishment of these new journals is welcomed, but our Association may well give heed to the growing pains of a lusty science.

There are other thrills in the editorial office. Possibly the term "thrill" is too strong a word, for this thrill has become almost a monotone. I refer to efforts to condense manuscripts into briefer space. Those of you who have shared in writing for the the *Review* doubtless have been irritated by these economies. Again, the excuse is pressure upon our space. But have we not the example of our national administration? If we plow under every third row of cotton, may it not be a good plan to plow under every third paragraph of a manuscript? At any rate, necessity requires a limitation on the production of words, and a rationing of the product between the different producers.

May I now turn to reflections of a more somber nature, which I trust will not infringe upon the jubilation of this notable anniversary? A moment ago I said I ought, from the opportunities granted me, to be an educated economist. As time runs on, and I look about me in these days of turmoil, I sometimes wonder whether I know any economics at all; and in the darkest moments of my despair I have even gone so far as to question if the twenty-five bulky volumes which face my desk have left any impress upon our national mind. Like Job, I am tempted to say, "Where shall wisdom be found? And where is the place of understanding? Upon my right hand rise the youth; they push away my feet, and they raise up against me the ways of their destruction."

The word "youth" should doubtless be given an elastic interpretation, for it will be remembered that Job lived more than a hundred and forty years.

However, economic depressions have their compensations, for at least we can see economic laws working to completeness. They do not have to be reviewed by a Supreme Court. It is not often that the economist has such a well-equipped laboratory at his disposal. No longer does he have to wait until old age to see the relationship between cause and effect. Even when energy is misapplied, there is a mournful satisfaction in witnessing a perfect demonstration of a destructive experiment. Undoubtedly the inventor of dynamite would have been disappointed if his concoction had failed to explode and tear the earth apart. And so, even in darkness, I receive some solace and renew my faith in the principles of our science.

The economist has learned to be very humble. Contrast him with the physicist. In the conduct of electrical energy the formulas of the physicist are slavishly followed by every practitioner; and the physicist, who has gone beyond the drudgery of explaining the relative merits of direct and alternating currents, can assail the public ear with his theories of neutrons, ions, protons, electrons, and other "tom-toms," and is regarded as wondrous wise and is a candidate for the Nobel Prize.

But let an economist talk about economic equilibria, economic incentives,

inelasticity of demand, and marginal social net product, and instead of being a candidate for a prize he is marked as Public Enemy No. 1.

Fortunately, he still has a refuge in the college classroom, where he can preach his outlawed philosophy to adolescent youth, whose minds are preoccupied with a host of other interests.

Or, perchance, he may have a group of more serious and advanced students who, after conversion to his program of truth, go forth and, like their masters, struggle with new re-enforcements of adolescent youth.

This is a sad picture, probably extravagant, and doubtless should be called a cartoon rather than a picture; but a cartoon sometimes has its lesson.

No economist can be indifferent to current policies of government. Economists do not frame our legislative acts; they are, however, concerned that legislators and administrators give decent respect to fundamental economic principles.

Economic concepts and political democracy appear to occupy two separate spheres. Our Toastmaster referred to the "Golden Wedding" anniversary of this Association. He did not tell us, however, to whom the Association was married. You may recall the conversation between a young man and a notable senator. The young man stated that so-and-so was an economic fact. The senator replied, "It may be an economic fact, but it is not a political fact, and Congress acts on political facts."

No one of us, I presume, wishes to abandon political democracy; but we should like to have economics (please note that I say "economics" and not "economists") invited to resettle from the lean, submarginal territory of the classroom onto the more fertile soil of political democracy. We believe that with such an opportunity we could reap a rich harvest. And this does not mean that we should grow the same crops as we did in the twenties.

No talk on economics nowadays is complete without some reference to the New Deal. I dislike the term "New Deal." It savors too much of a game of idle amusement in which chance plays a considerable rôle. I should prefer "New Plan," and I have hoped for a New Plan long before the present depression set in. However, if we must talk about the New Deal, let us use the language of the card player.

Much of the present New Deal is wrongly named. It is an Old Deal, based on rules which economics junked years ago. If we are to have a New Deal, let us have the cards played by those who know the rules. As yet, neither party has emerged from the rules of mid-Victorian whist. It is time to bring the rules down to date. This is an age of contract and big and little slams and disastrous penalties for getting set. Revoking is too common and too frequently the player trumps his partner's ace. We need to pray for a Culbertson, a Sims, a Work, or other bridge master mind, and the kibitzers should not crowd the players. Psychic bids should be rigidly shunned.

Some of us think that playing the Deal according to sound economic rules might not only restore prosperity but lead to a continuous abundance whereby the standard of living will ever be raised.

We must still look forward to a genuine New Deal. This is no time, however, to explain the rules; and I may be accused of drifting into frivolity. And so I

turn back to the Scriptures, and comfort myself by recalling the closing chapter of the biography of Job. Job lived through his trials; he raised a new family, and ". . . the Lord gave Job twice as much as he had before."

Chairman Fetter: After this demonstration it is unnecessary for the Toastmaster to adduce further evidence to prove that Dr. Dewey has been one of the most useful men in the American Economic Association. One of his great functions has been to bring us steeplejacks and spire-climbers back to earth. Over and over again we have thought to escape his clutches. We have started hopefully up the spire only to have him grab the bottom of our overalls and yank us back to earth. That was a service that we, at the moment, did not fully appreciate, but as we think it over and realize how our necks would have been inevitably broken, we thank him as the savior of our lives and in some measure of the reputation of this Association. Among friends, however, may we say that in the last couple of years he seems to have missed a few yanks.

I have here a telegram from Mr. Francis Walker, who was to be next on the program, but who regrets the necessity of having to stay away because of urgent public work, and sends his congratulations and best wishes. He was to appear particularly as representing the most noteworthy hereditary line of economists we have to exhibit. There are several cases of father and son being economists, but only this one that I know of that has continued for three generations. The grandfather, Amasa Walker, was a widely known teacher of economics. In the next generation, Francis Amasa Walker rose to even greater distinction in the public eye, as general, educator, economist, and the first President of this Association. And finally, the grandson, Francis Walker, has for many years given noteworthy service as Chief Economist of the Federal Trade Commission.

There should have appeared on the program, but because of a purely clerical oversight it was omitted, the name of Professor Richard T. Ely. At this time it would be superfluous to repeat the biographical details of Professor Ely's career, so well known to all of you. He was one of the most active in the founding of the American Economic Association, is a charter member, and is its well-known official historian. I trust he may to some extent supply the missing word regarding our first President, Francis A. Walker.

Richard T. Ely: Mr. Toastmaster, Members of the American Economic Association: I gave you last evening some account of the founding and of the early days of the American Economic Association. Several thoughts occur to me on this occasion. If we are the fathers of the American Economic Association, as I look about on this vast audience, recalling the handful of people at the first meeting, I think you will say that there is no danger of race suicide among the economists, and the Malthusian theory is comparable to the growth of the American Economic Association.

We say we are the fathers. Well, our students say, "You are my father; I am your spiritual child." That is all very delightful to us. That is the reward we have; the greatest reward. But I think of the old hen hatching out, as she thought, chickens, and beautiful ducklings appeared. And so it is with these children of ours. They do what we want our children to do—go farther ahead—but they are not the chickens we thought they were; they are beautiful ducklings.

If we speak about the founders of the American Economic Association and trace back a little bit beyond those who are the official founders, we come upon a group of men who were gentlemen of a high type, who were humanitarians, men of culture. Then it is that I think of Francis Walker, and I go even back of him to Andrew D. White, a gentleman of the highest type, a scholar of profound learning, a beautiful writer. I knew him when I was a young fellow in the twenties, in Berlin. He was very kind to me there. His doors were always open to me during the day or even, perhaps, during the night. I used to wonder why it was that he was so considerate and threw so many things in my way.

Well, there are several reasons, I suppose. One of the ideas we had, and I think it was a comparatively new idea in this country, was the idea of relativity. Andrew D. White was a protectionist and a Yale man. I think he did not like to be called muddle-headed simply because he was a protectionist. I advanced to him the idea of relativity in tariff policy and that evidently pleased him. You can see how an older man like that would be attracted by a young fellow with a lot of heresies; and he would listen to me patiently.

I want to say, too, that he asked me to write a report upon the administration of the City of Berlin—I still have in my possession a budget of the City of Berlin, with some of his corrections, made in ink. Then, too, he wanted a report, once, on the purchase of the Prussian railways. I thought at that time that he believed it very important for this young fellow to enlighten the American public about the purchase of private railways by the state. I found out later that other members of the staff thought they ought to have written the report. Well, of course, he was giving me an opportunity. I wrote the report and it appeared in the volume of *Foreign Relations* of 1881, and if you look there, you will find an account of the purchase of the private railways of Prussia by the state.

Nobody paid any attention to it at all. I was knocking around in New York City, looking for a job. I was teaching in private families to pay modest board bills. I wrote the editor of the *Evening Post,* Carl Schurz, at that time, and said, "I am a young fellow in New York City, looking for a job. I have made this report on the Prussian railways, but nobody pays any attention to it. Perhaps it has some merit—I don't know. If you think it is worth while could you say something about it?"

One day I chanced to pick up the *New York Evening Post* and there I found an editorial on this report of mine. Well, that showed what kind of a man Carl Schurz was. Out of the goodness of his heart he had waded through that report and had written it up in the editorial.

Just at this time I learned that Henry C. Adams who had been lecturing at the Johns Hopkins University was not going to return so I hastened down to Baltimore to put in my application for a position on the faculty. I think it is this editorial of Carl Schurz that turned the scales in my favor. I went then to the Johns Hopkins University in 1881 and remained there for eleven years. It was while there that I took my part in the founding of the American Economic Association.

I have gone beyond my time, but I do want to say a word of Francis Walker.

You know I spoke of him last evening. He was a scholar and a gentleman of a high type, with broad, generous ideas in regard to education. He was a humanitarian, and he wanted to make this a better and a happier world.

I recall walking with him along the streets of Baltimore. He was talking at the time of the Institute of Technology of Massachusetts. He said, "If I didn't think my boys were getting as good an education there as the Harvard boys, I would resign my job tomorrow." This gives you some idea of him in those early days. I could give you a lot of other anecdotes about Walker, but I have used up my time and will close with one more. I visited his home many times. It was a delight to go there, it was such a cultured home. I remember that he was very fond of expensive etchings, but his wife had to watch the family budget.

He would buy etchings and take them to his office and hang them there for a time, and then, gradually, they would work their way home.

His wife would ask him about them, where he had gotten them, how much they had cost, and so forth.

"Why," he would say, "I have had them a long time."

He was an inspiration to us all. He was one of the older men but he was our leader. He had broken the crust, and it was a hard crust, and he always stood by us and helped us. The Walker family has an enviable record. Recently I have been studying the career of Amasa Walker and have come to value him more highly than I did formerly. He really had a remarkable career and did a great work in his day. We have then in the Walker family three generations of economists and all have done good work in the field.

CHAIRMAN FETTER: Some time before ending this program we should mention the honor done us by the presence here of such distinguished guests as E. A. Ross, S. M. Lindsay, J. B. Andrews, W. I. King, E. T. Devine, and others here, representing the sister social science associations. There was also here until a few minutes ago, Professor Vittorio Racca, from the University of Rome, who, at another session, brought greetings from European economists. At still another session, Dr. Louis Lorwin brought greetings from the International Labor Office.

At our silver anniversary dinner twenty-five years ago, Mr. Henry Higgs was present, bringing the greetings of our British brothers from across the seas. I recall his telling this story, which somehow failed to be recorded in the printed proceedings: The British economists, he said, had been slow in becoming interested in the Austrian marginal economics, and what they did learn of it came mostly via America. Even the scholarly essays of James Bonar, which were written in Canada, were published first in the *Quarterly* at Harvard University. Mr. Higgs said that it reminded him of an experience he had as a young student when he was traveling on the Continent. In Paris he became acquainted with a scholarly German who said he was there to arrange for the translation into French of a four-volume German work of metaphysical philosophy. Mr. Higgs asked, "And what use would that be? No Frenchman would read a four-volume German work on philosophy even if it were translated into French." The German calmly replied, "I don't expect any Frenchman to read it. I am going to have it immediately translated back into German in the hope that by this process it will gain something in lucidity."

This is the "American" Economic Association, and while, for some purposes, we of the United States may monopolize the name, "American," for other purposes, it is international and inclusive of everything from the Gulf of Mexico to the North Pole. We have always enjoyed the valuable co-operation of our Canadian colleagues, and we now have here, by special invitation, Professor W. A. Mackintosh, from Queen's University, Canada, who comes as the representative of our brother economists from across the northern line.

W. A. MACKINTOSH: It is both a pleasure and a privilege to be the vehicle for the conveyance of greetings from the Canadian Political Science Association to the American Economic Association on the occasion of its fiftieth anniversary.

Ours is a very young organization with a well-established preponderance of economists. It has just reached that adolescent stage in which it has begun to publish its own quarterly.

Last evening Dr. Ely spoke of the stimulus which the founding of the American Economic Association had given to the study of economics in this and other countries. Whether from this stimulus or not, it was in the eighties that economics in Canada left the parental control of Moral Philosophy. The appointment of Adam Shortt to a lectureship in Political Economy at Queen's University in 1887 and of W. J. Ashley to a chair in the University of Toronto in the following year marks the beginning of its independent existence.

But I have no intention of tracing the development of economic studies in Canada. It has been, and will necessarily and happily continue to be closely related to the progress of economic science in the United States. Most of us are members of both the American and Canadian associations; many of us have been students in the graduate schools of the United States; there is a considerable body of Canadian emigrés who add distinction to your own number.

There is therefore no association to which the friendly greetings of Canadian economists are so freely given as to the American Economic Association; and in conveying these greetings to you, Sir, may I be permitted to extend them also to these men on either side of me, your founders, who are so much less venerable in years than in achievement. Canadian economists would like to add their grateful tribute to yours.

CHAIRMAN FETTER: We thank you and accept your greetings, and we hope we may be able to reciprocate.

On either side of me I am buttressed by the Clark family. Here on my right is John Bates Clark, a charter member and the president of the Association that I first saw in that office; and here on my left is John Maurice Clark, the last president, so far as my memory goes. The Clarks tonight symbolize our history—the Alpha and Omega of the American Economic Association. I have the great pleasure of presenting to you our retiring president, John Maurice Clark.

JOHN MAURICE CLARK: The Toastmaster has given me an opening for some remarks which were crowded out of my Presidential Address. I had been pondering on the phenomenon of the repeated demise of laissez faire; and I thought I had found the explanation by finding out what laissez faire is and what it is not. We are frequently told by our students that it means complete individual liberty and no control. If that is what it means, then it never has died, for the simple reason that it has never lived. There never was such a thing.

So, with that start, I wondered what it really did mean, and I came to a conclusion. I am not presenting this as a final definition and I realize that it is true only within limits; but I concluded that laissez faire really means whatever system and degree of control we have become so accustomed to that we accept it as natural.

Well, then, no wonder that it has nine lives! No wonder that it is something different in succeeding decades and that we can announce its demise repeatedly, in each case meaning some additional step taken in the development of control. It is not necessarily a repetition of the same demise.

When a family has moved into a house, it may be good for them to be reminded of the builders. When a generation has moved into a large, going concern like the American Economic Association, it is very good for them to be reminded of the time when there was no American Economic Association, when it had to be built up from the beginning, and when its only existence was in the ideals and aspirations and determination of the few men who set it up. That privilege we have enjoyed during these meetings, and especially this evening, and we are grateful for it; and may be increasingly grateful as time goes on.

In that connection, and perhaps because I am next to Professor Fetter, who deals in time perspectives, I am reminded of some of the peculiarities of time perspectives, as we look backwards into history. I think that what is near to us does not always seem larger than the things that are more distant; sometimes things that are more distant take on greater proportions. Perhaps that is partly a peculiarity of this young country. But as a boy I used to think of history as things I could not personally remember; and I thought of it as very long, compared to my own recollections, which were very short. But one's personal recollections do get longer without one fully realizing it. I can still hardly believe that my earliest childhood memories are only half as far in point of time from Lee's surrender as they are from this fiftieth anniversary of ours. And in that connection I invite your attention to the fact that the childhood recollections of the oldest man at this table go back more than halfway to the Battle of Lexington. What for him is the "history" of this country as I have defined it is actually shorter than what for him is personal recollection.

This illustrates the vast segment of the development of our country which the memory of one person can span. This being the case, it is hardly strange that the lifetime of one now living has witnessed changes in our theories, our attitudes, and our outlook. If our life channels have shifted, they have had time to!

If I, myself, have been to any degree a heretic, I want to absolve my father. He tried to bring me up in the proper path. He did not give me the treatment that James Mill gave to his son, but he gave me a gentle, homeopathic dose of it. There was one walk I took with him at the age of ten, during which he spoke of the man with the varying numbers of oranges, and explained the effect of that upon their marginal utility. I appeared to understand it. In fact, a candid friend has remarked that I probably understood it better then than I have at any time since.

With that start I should have been safely orthodox, and I have only recently realized why the protection was not perfect. He was too late. My mind was already tainted. A year or two before, some time between the ages of seven and

nine, I had found on the shelves in his study a book that interested me very much because it had pictures in it. It was called, *Coin's Financial School.* I was puzzled by the pictures and so, to solve the mystery of these strange pictures I read some of the text. I didn't understand much of it, though I was interested in that Mr. Laughlin whom the author took so many falls out of, and wondered if he were a real person. I would have been surprised to be told that he would one day be my chief. At any rate, I became a convinced free silverite, and later I was much disturbed to discover that my admired and respected father was on the wrong side of that question. I did not remain a heretic on that particular issue, but it was my first lesson in the necessity of readjusting my own preconceptions; and once that lesson is learned, almost any heresies become possible.

I appreciate more than I can tell you the chance to be here at this particular occasion, and in this particular capacity, by the side of the senior partner of the firm of Clark and Son.

The Toastmaster told me that I might have the privilege of presenting one other person who will not be asked to make a speech—the person in whose more capable hands the Association will be for the coming year. I am not going to tell you of his achievements. You have known him as maker of encyclopedias and founder and builder of novel and significant institutions of learning. I knew him first as my instructor—not so much older—in Columbia, and I have always had that attitude of respect and recognition of superiority which the student carries towards one who has been his instructor.

The thing that I remember that he taught me was the unwelcome necessity of distinguishing between classes of cases, and of scrutinizing those appealing universal propositions, to see whether they were not limited in their application to cases of types A, B, and C, whereas the opposite might be true of types D, E, and F.

And I remember him as one whose rugged exterior gave no immediate hint that he was an accomplished classical scholar before he was an economist, and that he wrote the best English style of any American economist, and one whose dry wit leads people perhaps to fail to do justice to the seriousness and kindliness and sincerity which underly it.

Professor Alvin Saunders Johnson—the incoming President!

ALVIN SAUNDERS JOHNSON: I am privileged not to make a speech! Nevertheless, if I can be heard, and it is doubtful, I would like to say just a few words.

I have an embarrassed feeling as a certain character in literature had when he appeared among the other sons of God. The gentle query was put, "Whence comest thou?"

The reply was, "From walking up and down upon the earth."

And the further query was, "And what did you see there?"

Walking up and down the earth you don't get the same impression of the ineffectiveness of the economist that you get when you reside in this higher sphere, where by grace and not by merit a seat has been reserved for me. Up and down the earth you may walk a great deal before you can find the pristine ignorance of economics that prevailed when I was a young man. Where you find it now, today, it is usually paid for by some editor or by some political party. The pristine ignorance was taken as the natural state of man, when I was a boy.

I think the change is due not only to the general extension of university education in the country and to the improvement of most of our literature; I think it is largely due to an accident in the foundation of the American Economic Association. If we had been so unfortunate as to have had the Association founded ten years earlier, when all economic thought was alike, it would have been impossible for this Association to be an expressive force through the years.

As it happened, the Association was founded when a group of people returned from Germany with ideas that looked queer, and when it was necessary to marry orthodoxy with the classical.

We used to hear the words "sound" and "unsound." We used to hear of heresies. We only hear that word "heresy" now in a humorous sense. The Association has served as a force, welcoming divergent ideas, as long as they do not diverge too far, but ideas that may diverge a little more year by year. And we are freer and have become a body of people more democratic than could have been expected of us thirty years ago, and still less fifty years ago, and that means that although we may not see immediate results in politics—results in public opinion are slow to make themselves manifest, and are never capable of qualitative determination—yet we expect that in time the associated economists will play a vast part in making those adjustments necessary for any society that is meant to survive.

CHAIRMAN FETTER: It is very difficult for a Toastmaster, under the stimulus of this occasion, when he sees before him the possibility of a continuous program for another fifty years, to bring this meeting to a close. Yet there must be an end to it, so I hereby proclaim this golden banquet of the American Economic Association adjourned until the last Saturday of December, 1985. May you all be present!

Those Present at the Fiftieth Anniversary Dinner

Speakers' Table

Clark, John Bates
Clark, John Maurice
Commons, John R.
Deibler, F. S.
Devine, Edward T.
Dewey, Davis R.
Ely, Richard T.
Fetter, Frank A.
Fisher, Irving
Johnson, Alvin
Lindsay, Samuel McCune
Mackintosh, W. A.
Seligman, Edwin R. A.
Taussig, F. W.

Abramovitz, Moses
Agger, Mr. and Mrs. E. E.
Anderson, Mr. and Mrs. B. M.
Anderson, Bobby
Anderson, Jack
Arbuthnot, C. C.
Armstrong, Mr. and Mrs. F. Floyd

Baer, W. N.
Barnett, George E.
Barrett, Don C.
Beckhart, Mr. and Mrs. B. H.
Bidwell, P. W.
Blakey, Mr. and Mrs. Roy G.
Boone, Gladys
Bratter, H. M.
Breckenridge, Frank P.
Brinton, W. C.
Brofford, Mr. and Mrs. E. B.
Brown, Emily

Capen, E. W.
Catlin, W. B.
Chalmers, Henry
Clark, Mrs. J. B.
Clark, Mrs. J. M.
Clark, L.
Cumberland, W.
Cummings, John
Custis, V.
Crawford, A. W.

Davenport, D. H.
Davis, E. H.
Davis, William
Davison, Sol
Dempsey, B. W.
Devine, Mrs. E. T.
Dickinson, F. G.
Dublin, Mary
Duffus, R. L.
Duffus, W. M.

Eastwood, Robert
Edwards, Mr. and Mrs. G. W.
Ely, Mrs. Richard T.
Epstein, R. C.

Fetter, Ellen C.
Fetter, Frank W.
Field, E. D.
Fisher, E. M.
Fisk, W. P.
Foerster, R. F.
Fossum, P. R.
Fox, A. M.
Freeman, R. E.
Friedman, Francis
Friedman, H. G.
Friedman, Milton
Friday, Mr. and Mrs. David

Gardner, H. B.
Gay, Edwin F.
Gay, Margaret
Gill, John D.
Ginzberg, Ely
Glasser, Cary
Glenn, John M.
Goldstein, J. A.

Gourvitch, A.
Grady, Mrs. F. H.
Green, W.
Gresham, H. D.
Groat, G. G.

Haensel, Paul
Haig, Mr. and Mrs. R. M.
Hall, Lolabel
Hamilton, R. S.
Hardy, C. O.
Harris, Mr. and Mrs. L. H.
Harris, S. E.
Hastings, John
Hess, Mr. and Mrs. R. H.
Hawkins, E. D.
Hollander, Jacob H.
Hutchinson, Mr. and Mrs. Arthur R.
Hughes, James

Jamison, C. L.
Jerome, Harry
Johnson, Mrs. Alvin
Jones, M.

Kaldor, Mr. and Mrs. Nicholas
Kaplan, A. D. H.
Kellogg, Ruth M.
Kemmerer, Donald
Kemmerer, Mr. and Mrs. E. W.
Kiekhofer, W. H.
Killough, Mr. and Mrs. Hugh B.
Kleene, G. A.
Knight, Frank H.
Krauskopf, R. M.

Lagerquist, W. E.
Lampen, Dorothy
Learned, Mr. and Mrs. E. P.
Leavens, D. H.
Lederer, M. F.
Leibling, J.
Le Rossingol, J. E.
Lewis, Mabel
Lindsay, Mrs. Samuel McCune
Lorwin, L.
Love, R. A.

Magee, A. M.
Magee, J. D.
Maynard, H. H.
McFall, R. J.
McKinley, Mr. and Mrs. S. J.
Millis, H. A.
Mills, H. E.
Mitchell, Mary
Mitchell, Mr. and Mrs. W. C.
Muntz, E. E.

Newcomer, Mable
Norton, T. L.

O'Leary, P. M.
Overacker, Louise

Paris, Mr. and Mrs. J. D.
Pasel, Lawrence
Patterson, S. H.
Petersen, E.
Peterson, Florence
Piquet, H. S.
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Racca, Vittorio
Ratzlaff, C. J.
Raymaker, Constance
Reed, H. E.
Reeves, H. E.
Reilly, E. E.
Remer, C. F.
Riddle, Mr. and Mrs. J. H.
Roberts, Hazel V.
Robey, Ralph
Robnett, R. H.
Rosewater, Mr. and Mrs. Victor
Ross, E. A.
Ruggles, C. O.
Ruggles, Catherine G.

Sanders, Henry
Saulnier, R. J.
Salz, A.
Schaffner, J. H.

Schweinitz, Dorothy de
Seligman, Mrs. E. R. A.
Shafer, J. E.
Sharfman, I. L.
Sigsbee, R. A.
Simkhovitch, V. G.
Slade, Mrs. Helen
Smith, M. A.
Slichter, S.
Spahr, Mr. and Mrs. Walter
Spurrier, Leo
Stone, N. I.
Sumner, J. D.
Sundelson, J. W.
Starr, Myrtel

Tait, Gertrude
Taylor, G. R.
Taylor, H. C.
Taylor, H. G.
Thorp, W. L.
Tippetts, C. H.
Toan, Winthrop
Tough, Rosalind
Trumbower, H. R.
Tucker, D. S.

Valentine, R. W.
Viner, Mr. and Mrs. J.

Walker, Mabel L.
Walker, Q. F.
Weber, Adna F.
Wallace, Mr. and Mrs. Benjamin B.
Watkins, Ralph
Weisman, Mr.
Wermel, M. T.
Westerfield, Mr. and Mrs. R. B.
Weyforth, W. O.
Willcox, W. F.
Withers, Mr. and Mrs. W.
Wolf, F. E.
Wolfe, A. B.
Wythe, George

Young, John Parke

Zelomek, A. V.
Zimmermann, Mr. and Mrs. E. W.

The above list is, we believe, fairly complete. In a few instances we did not have the names of guests of the members, and it is possible that a few late comers have been omitted.

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